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COMPENSATION MANAGEMENT

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SYLLABI-BOOK MAPPING TABLE

COMPENSATION MANAGEMENT

Syllabi	Mapping in Book
BLOCK I: BASICS OF COMPENSATION MANGEMENT **UNIT 1** Introduction to Compensation, Rewards, Wage Levels and Wage Structures; Introduction to Wage - Determination Process and Wage Administration rules; -Pay - Compensation based on macroeconomic - micro economic factors - wage settlement - safety measures **UNIT 2** Introduction to Factors Influencing Wage and Salary -Structure and Principles of Wage and Salaries Administration Wage theories - Evaluation of theories - Components of compensation - implications - problems - prospects **UNIT 3** Introduction to Minimum Wages; Introduction to Basic Kinds of Wage Plans; Introduction to Wage- Differentials & Elements of a Good Wage Plans Wage Fixation Factors: Job factors - Personnel factors - Company factors **UNIT 4** Trade unionism - Price levels - Competition factors - perfect competition - imperfect competition	**Unit 1:** Introduction to Compensation, Rewards, Wage Levels and Wage Structures **(Pages 1-20)** **Unit 2:** Wage and Salary Structure: An Overview **(Pages 21-36)** **Unit 3:** Minimum Wages: An Overview **(Pages 37-49)** **Unit 4:** Trade Unionism **(Pages 50-68)**
BLOCL II: PROCESS OF PAY FIXATION **UNIT 5** Pay Fixation Process: Surveying pay and compensation practices - Designing pay structure. **UNIT 6** Incentive Schemes: Monetary and Non-monetary dimensions - Incentive plans - Incentives for direct and indirect categories **UNIT 7** Introduction to Importance of Wage Differentials; Introduction to Executive Compensation and Components of Remuneration Individual/ group incentives - Fringe benefits/ perquisites - Profit sharing **UNIT 8** Introduction to Nature and Objectives of Job Evaluation; Introduction to Principles and Procedure of Job Evaluation Programs; Introduction to Basic Job Evaluation Methods; Employee Stock Option Plan - Non-monetary incentive schemes: Types and relevance.	**Unit 5:** Pay Fixation Process **(Pages 58-81)** **Unit 6:** Incentive Schemes **(Pages 82-94)** **Unit 7:** Wage Differentials **(Pages 95-112)** **Unit 8:** Introduction to Job Evaluation **(Pages 113-133)**
BLOCK III: KPPAND PERFORMANCE COMPENSATION **UNIT 9** Performance Linked Compensation: Measuring performance - KPP - implications - problems - prospects Introduction to Implementation of Evaluated Job; Introduction to Determinants of Incentives; Introduction to Classification of Rewards; Incentive Payments and its Objectives. **UNIT 10** Introduction to Institutional Mechanisms for Wage Determination Performance parameters - service benefit - merit cum reward-citation- token of gift - promotions **UNIT 11** Performance compensation - Structure - measures - Key performance parameters - Control of employee cost - implications - problems.	**Unit 9:** Performance Linked Compensation **(Pages 134-153)** **Unit 10:** Institutional Mechanisms for Wage Determination and Merit Cum Rewards **(Pages 154-178)** **Unit 11:** Performance Compensation **(Pages 179-192)**

CONTENTS

INTRODUCTION

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Compensation management is an integral part of the functioning of every organization. Employees need to be managed efficiently for the smooth functioning of the organization. They can be motivated to work harder by providing attractive remuneration and compensation packages, as per the industry standards. Lucrative compensation will also serve the need for attracting and retaining the best employees. It is an organized practice that includes balancing the work-employee relation by providing monetary and nonmonetary benefits to employees.

This book, *Compensation Management*, is divided into four blocks and fourteen units. The first block introduces the basics of compensation management which includes introduction to compensation, factors influencing wage and salary, wage plans and trade unionism. The process of pay fixation, incentive schemes, importance of wage differentials and nature and objective of job evaluation has been covered in the second block. The third block discusses KPP and performance compensation, introduction to institutional mechanism and performance compensation. The fourth and last block deals with the current trends in wage incentives and compensation.

The book is written strictly in SIM (Self Instructional Material) format for Distance Learning. Each unit starts with an Introduction and Objectives. Then, the detailed content is presented, along with figures and tables, in an understandable and organized manner. Each unit will also have Check Your Progress questions to test the readers' understanding of the topics covered. A Summary along with a list of Key Words and a set of Self Assessment Questions and Exercises is also provided at the end of each unit for effective recapitulation. Each unit also has a list of books for Further Reading.

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BLOCK - I
BASICS OF COMPENSATION MANGEMENT

UNIT 1 INTRODUCTION TO COMPENSATION, REWARDS, WAGE LEVELS AND WAGE STRUCTURES

Structure

1.0 INTRODUCTION

When we speak of employee compensation, we basically do not refer to the base salary but we speak in terms of the complete compensation package inclusive of the base salary. Apart from the base pay, a compensation package broadly consists of other components, like benefits, allowances, incentive schemes, etc. This unit will focus our attention on components that constitute a compensation package. Every organization attempts to make its compensation package attractive not only to attract talent into the organization, but also to retain the existing talent within the organization. Besides these two aims, compensation packages attempt to provide incentives or rewards to employees for the performance and contribution to organization. In this unit, you will learn about the pay structure, its types and the

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process of developing pay structures. Organizations develop pay structures not only to suit organizational and employee needs but also to make a statement about their values of equity and justice. You will explore the defining features in detail in this unit. We will discuss all the types of pay structures along with their features, strengths and limitations.

1.1 OBJECTIVES

After going through this unit, you will be able to:

- Understand the compensation, rewards, and wage system
- Describe the wage administration and determination process
- Discuss the wage settlement and safety measures at workplace

1.2 INTRODUCTION TO COMPENSATION, REWARDS AND WAGE SYSTEM

All organizations have goals and objectives that they seek to achieve by using, along with other elements, the knowledge, skills and abilities of their employees. It is this need of the organization that makes it hire individuals with the required skill-sets. On the other hand, individuals too need organizations so that they are gainfully employed and their basic needs are fulfilled. In fact, it is the classic situation of 'What I have you don't and what you have I don't' that provides the basis for exchange. Employees provide knowledge, skills and abilities desired by the organization to meet its goals and the organization in turn provides money, goods and services. It is this receipt of the employees that constitutes compensation or reward. This process of exchange between organization and employees is aptly described by Bloom and Milkovich as 'a bundle of returns offered in exchange for cluster of employee contributions'. Before we proceed to understand the role of compensation, it is imperative that we should understand the concepts associated with compensation and know the components that constitute employee compensation.

According to Michael Armstrong, 'An employee reward system consists of an organization's integrated policies, processes, and practices for rewarding its employees in accordance with their contribution, skill, competence, and their market worth'. An organization develops its reward system within its framework of reward philosophy, reward strategies, policies and government regulations. A typical reward system will contain processes, procedures and structures that maintain the grades, types and levels of pay and other benefits (Figure 1.1).

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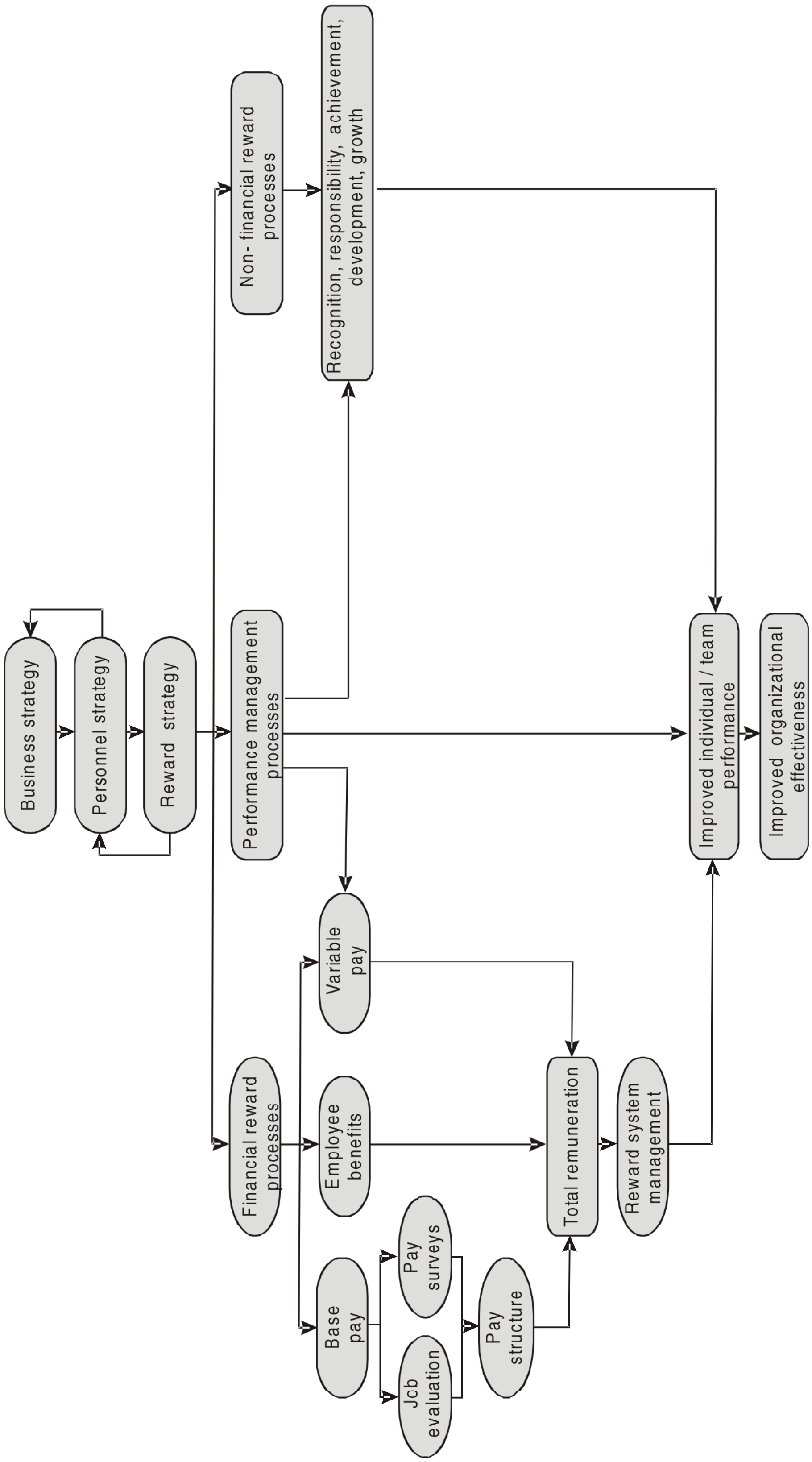

***Fig. 1.1** The Reward System*

A compensation system consists of total remuneration received by an employee inclusive of financial rewards (fixed and variable pay) and the benefits. Reward system also incorporates non-financial rewards such as recognition, praise, achievement, responsibility, personal growth and so on. Hence, an organization's reward system consists of financial rewards, employee benefits and non-financial compensation. Following are the main components of an organization's reward system:

- Processes adopted for measuring the value of jobs and contributions made by each employee in those jobs.
- Processes adopted to determine the level and extent of employee benefits to be provided.
- Structures put in place to link pay and benefits to the value of the position.
- Practices used for rewarding people based on their knowledge, skill and abilities.
- Practices used for motivating employees by using financial and non-financial rewards.
- Schemes and methods for rewarding performance.
- Procedures for efficient functioning of wage and salary administration.

The Oxford English Dictionary defines a system as 'a set or assemblage of things connected, associated or interdependent, so as to form a complex whole'. A reward system of an organization is precisely what the definition says, that is, a complex set of interconnected processes. For understanding the concept of reward system, we shall outline the basic elements that constitute an employee reward. Broadly, the term compensation refers to the way in which an employee is compensated for his efforts by an organization. Rewards offered by organizations may take many forms but generally they may be divided into intrinsic and extrinsic rewards (Figure 1.2).

(a) **Intrinsic rewards** are rewards that are associated with the job itself. These rewards do not have any obvious external incentive but are linked to the positive satisfaction derived from performing meaningful work or accomplishing a task. Intrinsic rewards are basically self-administered rewards. Individuals often value intrinsic rewards more highly and therefore they are more effective in the long-term.

(b) **Extrinsic rewards** are rewards that are external by nature and are linked with the individual's knowledge, skills and abilities. These rewards are dependent on the roles of an individual in an organization. They are tangible and consist of pay, benefits, bonuses and so on. Extrinsic rewards are inclusive of those rewards that an individual receives from sources other than the job itself.

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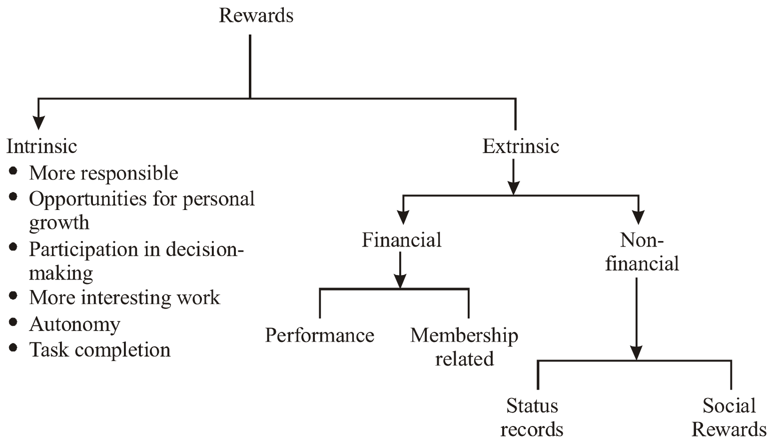

Fig. 1.2 *Types and Structures of Rewards*

1.2.1 Characteristics of Rewards

As a concept, there have been various definitions of the term 'reward' but for a reward to be called so, it must have the following characteristics:

- The reward must be a definite positive gain for the individual. It must have value for the individual, that is, it must fulfill some basic need.

  A reward which has no value for an individual will not be perceived as a reward.
- Rewards must be predetermined, that is, an individual must know beforehand what exactly he is going to get in return for performing the task or job.
- Rewards must not only have value but should also be of relevance to the individual. For example, a company accommodation would be of no relevance for an employee who already owns a house.
- Reward must be personal, that is, for a particular individual for a particular work.
- Rewards must be associated with a purpose or must serve a purpose. The purpose could be from motivating an employee to recognition of an employee's contribution.
- Rewards must have a positive behavioural effect on the individual on whom it is bestowed.
- Most importantly, both the giver of the reward and the receiver must acknowledge the fact that an act of rewarding has taken place.

Check Your Progress

1. How do Bloom and Milkovich describe the process of exchange between organization and employees?
2. What does a typical reward system consist of?

1.3 WAGE LEVELS AND WAGE STRUCTURES

A wage is a monetary compensation or financial remuneration that is paid by an employer to an employee to complete their work or provide their services. For an example, a worker may be paid ₹ 100 per day or ₹ 4500 per month. The employees provide their services at their best and take payment from the employers, which is called wage payment. Wages are usually paid in cash at the end of one day, one month, or one week. Such compensation is also called salary or reward given by an organization to a person in return of their work.

1.3.1 Wage Level

The wage level represents the money that an average worker makes in a geographical area or in the organisation. Payment may be calculated as a fixed amount for each task completed or on an hourly or daily rate basis for their services. Payment by wage contrasts with salaried work, in which the employer pays an arranged amount at steady intervals such as a week or month notwithstanding the hours worked, with compensation that conditions pay on individual performance and the performance of the company. Salaried employees may also receive gratuity or tips that is paid directly by clients and employee benefits for their whole performance, which are non-monetary forms of compensation. Since salaried labour is the leading form of work, the term, 'wage', sometimes refers to all forms that is all monetary forms of the employee compensation. Generally, compensation payable to an employee includes the following three components:

- Basic compensation for the job (wage/salary).
- Incentive compensation for the employee on job.
- Supplementary compensation paid to employees (fringe benefit and employee services).

1.3.2 Wage Structure

Wage structure is the hierarchy within a company that sets the amount for each level of employment and the benefits due to each level. Lower-level employees are paid less than higher-level employees in the organization and these lower-level employees may get an hourly wage as opposed to a set salary. This means that if an employee misses work, then he or she would lose out on those wages. However, these employees are also due overtime, if earned. Higher-level individuals in a company are more likely to receive far greater compensation for their work due to the responsibilities they have. Additionally, these individuals may be able to

earn better with more benefits. Figure 1.3 represents the components of wage structure.

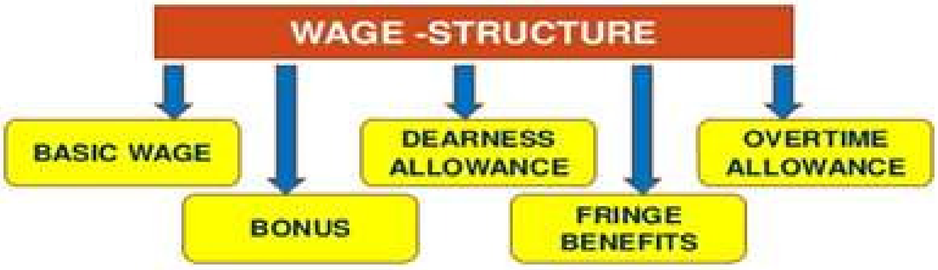

Fig 1.3 *Components of Wage Structure*

It may mean the way the total wage of a worker or group of workers is composed; for example, including such elements as a basic rate, a piecework bonus and other forms of bonus, overtime, etc. It may also mean the established system of pay differentials between groups of workers by occupation or the pattern of differentials on the basis of grade or status.

1.4 INTRODUCTION TO WAGE

The basic purpose of wage and salary administration is to establish and maintain an equitable wage and salary structure. Its secondary objective is the establishment and maintenance of an equitable labour-cost structure, i.e., an optimal balancing of conflicting personnel interests so that the satisfaction of employees and employers is maximized, and conflicts minimized. The wage and salary administration is concerned with the financial aspects of needs, motivation and rewards.

1.4.1 Determination Process

The steps involved in the wage determination process steps are as follows:

- Performing job analysis
- Wage surveys
- Analysis of relevant organizational problems forming the wage structure
- Framing rules of wage administration
- Explaining these to employees
- Assigning grades and price to each job and paying the guaranteed wage

Figure 1.4 illustrates the steps involved in the determination of wage rates.

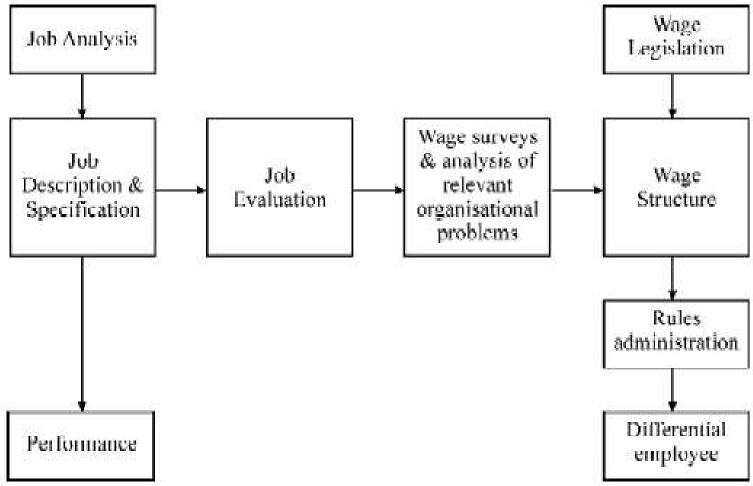

Fig. 1.4 *Steps Involved in Determination of Wage Rate*

1.4.2 Wage Administration Rules

One of the objectives of economic planning is to raise the standard living of the people. This means that the benefits of planned economic development should be distributed among the different sections of society. Therefore, in achieving a socialistic pattern of society the needs for proper rewards to the working class of the country can never be overemphasized. A national wage policy thus aims at establishing wages at the highest possible level, which the economic conditions of the country permit and ensuring that the wage earner gets a fair share of the increased prosperity of the country as a whole resulting from the economic development.

The term 'wage policy' here refers to legislation or government action calculated to affect the level or structure of wages or both, for the purpose of attaining specific objectives of social and economic policy.

Objectives of National Wage Policy

The objectives of the National Wage Policy are as follows:

- To eliminate malpractices in the payment of wages.
- To set minimum wages for workers, whose bargaining position is weak due to the fact that they are either unorganized or inefficiently organized.
- To rationalize inter-occupational, inter-industrial and inter-regional wage differentials in such a way that disparities are reduced in a phased manner.
- To ensure reduction of disparities of wages and salaries between the private and public sectors in a phased manner.
- To compensate workers for the raise in the cost of living in such a manner that in the process the ratio of disparity between the highest paid and the lowest paid worker is reduced.

- To provide for the promotion and growth of trade unions and collective bargaining.
- To obtain for the worker's a just share in the fruits of economic development.
- To avoid following a policy of high wages to such an extent that it results in substitution of capital for labour thereby reducing employment.
- To prevent high profitability units with better capacity to pay a level of wages in excess to the prevailing level of wages in other sectors.
- To permit bilateral collective bargaining within national framework so that high wage islands are not created.
- To encourage the development of incentive systems of payment with a view to raising productivity and the real wages of workers.
- To bring about a more efficient allocation, utilization of man-power through wage differentials and appropriate systems of payments.

Regulations adopted by the state

In order to achieve the above objectives under the National Wage Policy, the following regulations have been adopted by the State:

- Prescribing minimum rates of wages
- Compulsory conciliation and arbitration
- Wage boards

(a) Minimum wages: In order to prescribe the minimum rate of wages, the Minimum Wages Act, 1948, was passed. The act empowers the government to fix minimum rates of wages in respect of certain sweated and unorganized employments. It also provides for the review of these wages at intervals not exceeding five years.

(b) Compulsory conciliation and arbitration: With the object of providing for conciliation and arbitration, the Industrial Disputes Act, 1947, was passed. It provides for the appointment of Industrial Tribunals and National Industrial Tribunals for settlement of industrial disputes including those relating to wages.

(c) Wage boards: A wage board is a tripartite body with representatives of management and workers, presided over by a government nominated chairman who can act as an umpire in the event of disagreement among the parties. Technically, a wage board can make only recommendations, since there is no legal sanction for it, but for all practical purposes, they are awards which if made unanimously are considered binding upon employers.

Wage policy in a developing economy

A suitable wage policy for a developing economy must ensure economic growth with stability. If the wage level is too high it will hamper industrial growth. If the wage level is too low, it will adversely affect the workers. Therefore, a proper

wage level is necessary to sustain a study growth of the economy. There are two main considerations in wage fixation. They are:

- To adjust wages to cost of living (need based wages),
- To link wages with productivity.

I. Need-based wages: The meaning of the term 'need-based wage' is that a worker and his family are provided with not only bare necessities of food, clothing and shelter but also children's education, proper health service requirements of essential social needs and a measure of insurance against misfortunes and old age. The Indian Labour Conference held in 1957 accepted the following norms of determining the need based wage:

- The standard working family should consist of three consumption units.
- The minimum requirements of food should be calculated on the basis of net intake of calories as recommended by Dr. Wallace Aykroyd.
- The clothing requirements should be taken as 18 yards per head per annum.
- As for housing, the rent corresponding to minimum provided under the Government Industrial Housing Scheme.
- Fuel, lighting, and other miscellaneous items should constitute 20 per cent of the total minimum wage.

However need-based wage has many practical difficulties. If wages are raised to the need-based wage level and there is no corresponding increase in productivity, there is bound to be inflationary rise in prices. Further the capacity of the industry to pay is relevant. This capacity of industry to pay will depend on the productivity of labour.

II. Linking wages with productivity: Improvement in wages can result mainly from increased productivity. However, no attention is being paid to productivity, and wages are being either increased on an ad hoc basis or on the basis of cost of living. The Third Plan observed that 'for workers no real advance in their standard of living was possible without steady increase in productivity, because any increase in wages generally beyond certain narrow limits, would otherwise be nullified by a rise in prices'. However, linking wages with productivity arises on account of the following difficulties. They are:

- Productivity in India is low. Since productivity is low, wages will have to be low. This position is totally unacceptable to the workers.
- Employers are opposed to the linking of wages with productivity because they are not interested in productivity but profitability.
- Even employees are opposed to the linking of wages with productivity because they feel that low productivity is due to poor management.
- Employers argue that the increase in output is not due to the worker's effort but because of improvement in technology, plant and machinery.

- There is the difficulty of assessing productivity especially in industries where the output does not consist of standardized units.

III. A suitable wage policy: A suitable wage policy in a developing economy should aim at:

- Containing the rise in prices which can be achieved through a suitable monetary and fiscal policy
- Linking wage increases to increase in productivity

Principal constituents of the National Wage Policy

Three reports on the National Wage Policy were presented in the post-independence period. They are as follows:

- Report of the National Commission on Labour (1969)
- Professor S. Chakrovarty Committee Report (1973)
- S. Bhoothalingam Committee Report (1978)

The above mentioned reports have raised several issues concerning wage policy:

(i) **Minimum wage:** The National Commission on Labour describes living wage as 'a measure of frugal comfort including education of children, protection against ill health, requirements of essential social needs and some insurance against the more important misfortunes.' Thus according to this definition 'living wage' provides for a bare physical subsistence and for the maintenance of health. On the other hand, 'minimum wage' includes not only living wage but also provides for some measure of education, medical requirements and amenities. In other words, 'minimum wages' provides a worker with physical subsistence, maintenance of health, requirements of essential social needs and some measure of education for self and for children.

The National Commission on Labour states 'the first claim is of the worker for a basic minimum wage irrespective of any other consideration'. Thus, the minimum wage prescribes the lower limit; the upper limit will be set by the capacity of the industry to pay.

(ii) **Fair wage:** The Committee on Fair Wages felt that between the two limits, the actual wage would depend on:

- The productivity of labour;
- The prevailing rate of wages;
- The level of national income and its distribution;
- The place of industry in the economy of the country, and
- The degree of unionization of labour in the industry.

Thus, fair wage is something more than the minimum wages. It is the wage fixed by considering several factors such as wage rate prevailing in other industries in the location, similar industries, ability of the firm to pay wages etc.

(iii) **Wages and productivity:** Wages should be linked to productivity because an industry's capacity to pay would be determined by productivity. Furthermore, a raise in productivity provides legitimacy to the claims of labour for a higher wage.

Productivity is measured by VAM (value added by manufacture). VAM is not the result of the effort of labour alone. Along with labour, capital, technology and management also contribute towards productivity. Therefore, it would be highly incorrect to appropriate the entire productivity to labour alone. The National Commission on Labour disclosed that in the first decade of planning, labour did not benefit from the gains in productivity of the industry. However, in the next two decades, a part of the gains in productivity was shared by labour, though labour did not share it in a disproportionate manner.

Failure of the National Wage Policy

Although several commissions have deliberated on the need for evolving a National Wage Policy, but so far there is not enough evidence towards its emergence. There is an all-round failure in implementing minimum wages in the private sector. There still exist inter-industry and inter-occupational differences in wages. Further, there is the failure to restrain the increase of wages and salaries in the public sector far in excess of the raise in consumer price index. Even though the National Wage Policy has failed on many counts, there is still a sufficient degree of consensus on the objectives of National Wage Policy.

Check Your Progress

3. What are the components of compensation that is, payable to an employee?
4. What is the secondary objective of wage and salary administration?
5. Mention any two objectives of the National Wage Policy.

1.5 PAY

A pay or payment is an exchange between two parties for goods and services. It includes many forms such as barter system, money, credit/debit card, cheques, etc. In terms of compensation, payment can be calculated as a fixed amount for each task completed, on hourly basis, or based on an easily measured quantity of work done. Payment by wage is different than a salaried work, in which the employer pays an arranged amount at regular intervals regardless of hours worked. The compensation includes following components:

(a) **Job descriptions:** A critical component of both compensation and selection systems, job descriptions define, in writing, the responsibilities, requirements, functions, duties, location, environment, conditions, and other aspects of jobs. Descriptions may be developed for jobs individually or for entire job families.

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(b) **Job analysis:** The process of analyzing jobs leads to the development of job descriptions. Job analysis techniques include the use of interviews, questionnaires, and observation.

(c) **Job evaluation:** A system for comparing jobs for the purpose of determining appropriate compensation levels for individual jobs or job elements. There are four main techniques: Ranking, Classification, Factor Comparison, and Point Method.

(d) **Pay structures:** Useful for standardizing compensation practices. Most pay structures include several grades with each grade containing a minimum salary/wage and either step increments or grade range. Step increments are common with union positions, where the pay for each job is pre-determined through collective bargaining.

(e) **Salary surveys:** Collections of salary and market data. May include average salaries, inflation indicators, cost of living indicators, salary budget averages. Companies may purchase results of surveys conducted by survey vendors or may conduct their own salary surveys. When purchasing the results of salary surveys conducted by other vendors, it is important for companies to note that surveys could be conducted within a specific industry or across industries as well as within one geographical region or across different geographical regions. It is necessary to know which industry or geographic location the salary results pertain to before comparing the results to your company.

1.5.1 Compensation Based on Macroeconomic and Microeconomic Factors

A macroeconomic factor is an influential fiscal, natural, or geopolitical event that broadly affects a regional or national economy. Macroeconomic factors tend to impact large populations, rather than just a few select individuals. Examples of macroeconomic factors include economic outputs, unemployment rates, and inflation. These indicators of economic performance are closely monitored by governments, businesses, and consumers alike. It is important for organizations to develop a compensation program that recognizes the lifestyle and standard of living of all employees. To survive in a complex, competitive global economy, all organizations, private and public, must focus on the effective and efficient delivery of the products that they are designed to offer. A key factor in promoting effective delivery of essential goods and services is the provision of a performance based remuneration system for all workers.

Compensation management provides a step by step approach for designing a remuneration system that recognizes job requirements; employee related knowledge and skills and performance related incentives that link individual, team, work unit, and organization's performance. Total remuneration also includes a host of benefits that protect and expand the lifestyle and health of workers and their families. More than ever before, the compensation professionals must be

able to support all activities that will make the organization more successful. From the beginning of these organizational redesign efforts, compensation professionals have been called upon to identify:

- Jobs in which worker efforts can be combined
- Unneeded jobs
- Jobs, in which, incompetent, obsolete or unneeded employees are being hidden

In addition, these same compensation professionals are being asked to redesign compensation and reward programs to improve employee morale and motivation, while keeping labour costs within specified limits. To assist their organizations in competing while functioning within these often conflicting requirements, compensation professionals have had to increase their knowledge and skills dramatically. Because of these advances in knowledge and skills, the importance of the compensation professionals has risen in the managerial professional world.

Microeconomics is the social science that studies the implications of human action, specifically on the utilization and distribution of scarce resources. Microeconomics shows how and why do different goods have different values, how do individuals make more efficient or more productive decisions, and how do individuals best coordinate and cooperate with one another. Generally speaking, microeconomics is considered a more complete, advanced, and settled science than macroeconomics. Microeconomics studies the decisions of individuals and firms to allocate resources for production, exchange, and consumption. It deals with prices and production in single markets and the interaction between different markets, but leaves the study of economy-wide aggregates to macroeconomics. Micro-economists use mathematics as a language to formulate theories and observational studies to test their theories against the real world performance of markets.

1.5.2 Wage Settlement

Wage settlement is an agreement over wages following negotiations between workers and employers. Payment of the compensation is one time settlement for a certain period of time to the employee. Wage settlements are defining moments in an organization's history, particularly for the workmen and the unions. For the Unions, it is an occasion to show their leadership skills and extract their worth or their pound of flesh for the work they did in the organization. It is also an occasion to try and address some of the major concerns and aspirations of the workmen and the only way in which they can improve their quality of life is through the income they secure from the organization. In the Indian environment, unions go into hibernation once a wage settlement is signed for the tenure of the agreement. They again spring to life when the settlement is to be signed.

For the organizations, it is an occasion for trepidation, for taking stock, and for planning how to strategize and chart a path through this period of reckoning.

Additional costs will be incurred in the organization. Some conflict could affect the business opportunity and growth potential, which will determine the future affordability. However, the workmen will already be aware of the company's financial position during the tenure of the settlement. They will also be well aware of the raise that have been given to the managerial and supervisory cadre of the company. They will also be well informed of the wage settlements that have been taking place in the region and industry and would have done their homework on what demands the company must give and what are the benefits they would like to get substantially revised. Though wage settlements have been taking place and there always has been an interest evinced from HR professionals as well as employees and trade unions on the amount of wage increase at the time of settlements, some changes have taken place that needs to be taken note of.

For the company, the occasion heralds a major opportunity for bringing about significant changes in the working habits (not work culture as a culture refers to positive capabilities and competencies), improving productivity, reducing waste or costs, enhancing efficiencies, etc. If this opportunity is lost, the Unions could become litigation minded and go through with Section 9A of the Industrial Disputes Act, which mandates a notice of change, which is both time consuming and costly. In the manufacturing, quite a lot of changes have taken place technologically. Robotics, Artificial Intelligence, 3-D Printing, Nanotechnology, and Internet of Things have transformed the workplace, giving it a heady advantage. Manning norms are now a miniscule of what they were earlier and the machines now know what export quality production is and what is likely to get rejected and alerts the worker well before he/she has commenced his/her work.

These changes are now more radical than what was earlier spoken of and achieved through techniques like the Maynard's Operational Sequence Technique (MOST). Many unions have embraced these techniques and many companies in the Pune and Nashik Industrial belt have agree to MOST. The other development that is noteworthy to take cognizance of is the spectacular settlements taking place. When companies like Buckhardt gives workers a ₹ 27,000 p.m. hike or a company like Sulzer gives ₹ 25,000 p.m. per worker increase, it not only raises the bar, it becomes difficult to strive for a reasonable and meaningful settlement. In the Pune Industrial Belt, the settlements signed in Thermax and Bajaj Auto Ltd are as defining for the managements like the Maruti. Violence and settlement became a defining feature in the employer dynamics as much as Sulzer and Maruti have become inspirations for Unions. The Settlement in Bosch, where workers had to agree to international norms for working on machines and the management deducting 8 days wages for their illegal strike is also something unions now have to fear when they negotiate wage settlements.

Line managers have also become more active in the wage settlement process, which was not there earlier. Negotiations used to involve somebody from finance, the plant head, and the Human Resource head. Now negotiations are preceded by meetings with the line managers and supervisors to work out their own wish list

and check lists that are a must in the wage settlement process. Such an involvement also ensures that what is contracted for and agreed to by the unions also get implemented. Managements are also seeking enhanced tenure of settlements and seeking four year of five year settlements with the SOP (Standard Operating Procedure) of a higher wage increase so that the three year negotiations get stretched. The Government Public Sector undertakings have five year settlements as the norm, which sometimes even is 10 years.

Unlike countries abroad, where wage negotiations take place annually and on an industry wide basis, here, the bargaining is company based. The settlements are for tenures that average about three years. However, there is a major difference here in that some companies have provisions for generous Dearness Allowance payments linked to the Consumer Price Index. This gives workmen benefits that are quite substantial and are an outgo and additional cost for the employer, who cannot recover it from the market place because of the competition. Thus, at the time of negotiating the Charter, apart from what was given at the time of settlement, the additional outgo by way of dearness allowance is also required to be considered. Traditionally, workmen and unions were not willing to look at this issue. But in the changed environment, we see that the trade unions and workmen have also become sensitive to this concern of the employer. The wage settlements thus also address the concern of the Indian employer on Dearness Allowance.

In the present environment, if any adverse or radical changes are required to be made, the company cannot expect the union leaders to canvass for the changes directly with the constituency unless the benefits offered by the company justify such an initiative. Thus, if the organization is not doing well, it is the management that must take the initiative to convey this to the constituency and this must commence well before the agreement expires. Keeping quiet during the entire tenure of the settlement and talking about it only before the settlement leads to a lot of suspicion in the minds of the constituency. If the company is not doing well then, it is also quite legitimate and this has something to do with the credibility of the communication of the management.

1.6 SAFETY MEASURES AT WORKPLACE

According to the Factories Act 1948, an occupier of an establishment has to ensure the health, safety and welfare of all the workers while they are at work in the factory. It is obligatory for an employer/occupier to ensure the provision and maintenance of plant and systems of work, which should be safe and without any health risks. Arrangements should be made to rectify risks involved in use, handling, storage, and transport of articles and substances.

The establishment should be monitored to check the quality of the premises; cleanliness; disposal of wastes and effluents; ventilation and temperature; dust and fume; artificial humidification; overcrowding; lighting; clean drinking water; latrines

and urinals; and spittoons. Safety of the worker must be ensured by installing and maintaining the machinery, mechanisms, transmission apparatus, tools, equipment, and machines in the best possible condition. Tools, equipment, machines, or products used must be organized properly guaranteeing the safety of workers.

The employer is obliged to take care of the worker's health and ensure safety by providing the means of rescue, the first aid, and the clean-up in case of an accident.

Free protection

According to the Sec 35 and 87 of the Factories Act, 1948, the factory requires employers to provide protective equipment (means of protection) to workers involved in hazardous work. The type of PPE needed depended on the nature of work being performed. It includes screens or suitable goggles for protection of eyes. The right use of PPE reduces risk of accident and illness, minimizes future medical costs, and helps in creation of safer working environment.

Training

According to the Sec 35 and 87 of the Factories Act, 1948, it is the responsibility of an employer to provide instruction, training, and supervision as is necessary to ensure health and safety at work for his/her employees.

Labour Inspection System

The Sec 9 of the Factories Act provides for a vibrant labour inspection system. However, the labour inspection system is state based. The Ministry of Labour and Employment, along with ministries specialized for certain industrial sectors (for example the Ministry of Power and Ministry of Mines) are responsible for formulating and administering laws and regulations related to labour and employment. The national legislation provides inspectors the power to enter workplace premises; examine; inquire or interview anyone; ask for or take copy of any prescribed register, record, or other document; and take measures and photographs. The labour inspector is also authorized to dismantle or subject machines to any process or test and take possession of any such articles or substances that seems to cause danger to health and safety, and detain it for so long as is necessary for such examination.

Check Your Progress

6. What is a macroeconomic factor?
7. What is job analysis?
8. What is the main mandate of the Factories Act 1948?
9. Which sections of the Factories Act, 1948 mandate the training of employees?

1.7 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Bloom and Milkovich describes the process of exchange between organization and employees as 'a bundle of returns offered in exchange for cluster of employee contributions'.
2. A typical reward system consists of processes, procedures, and structures that maintain the grades, types and levels of pay and other benefits.
3. The components of compensation that is, payable to an employee includes:
   (a) Basic compensation for the job (wage/salary).
   (b) Incentive compensation for the employee on job.
   (c) Supplementary compensation paid to employees (fringe benefit and employee services).
4. The secondary objective of wage and salary administration is the establishment and maintenance of an equitable labour-cost structure, i.e., an optimal balancing of conflicting personnel interests so that the satisfaction of employees and employers is maximized, and conflicts minimized.
5. Two objectives of the National Wage Policy are as follows:
   (a) To eliminate malpractices in the payment of wages.
   (b) To set minimum wages for workers, whose bargaining position is weak due to the fact that they are either unorganized or inefficiently organized
6. A macroeconomic factor is an influential fiscal, natural, or geopolitical event that broadly affects a regional or national economy. Macroeconomic factors tend to impact large populations, rather than just a few select individuals. Examples of macroeconomic factors include economic outputs, unemployment rates, and inflation.
7. Job analysis is the process of analyzing jobs, which leads to the development of job descriptions. Job analysis techniques include the use of interviews, questionnaires, and observation.
8. The main mandate of the Factories Act 1948 is that an occupier of an establishment has to ensure the health, safety and welfare of all the workers while they are at work in the factory.
9. The Sec 35 and 87 of the Factories Act, 1948 mandated that it is the responsibility of an employer to provide instruction, training, and supervision as is necessary to ensure health and safety at work for his/her employees.

1.8 SUMMARY

- When we speak of employee compensation, we basically do not refer to the base salary but we speak in terms of the complete compensation package inclusive of the base salary.

- Apart from the base pay, a compensation package broadly consists of number of other components, like benefits, allowances, incentive schemes, etc.
- Employees provide knowledge, skills and abilities desired by the organization to meet its goals and the organization in turn provides money, goods and services. It is this receipt of the employees that constitutes compensation or reward.
- A wage is a monetary compensation or financial remuneration that is paid by an employer to an employee to complete their work or provide their services. For an example, a worker may be paid ₹ 100 per day or ₹ 4500 per month.
- The wage level represents the money that an average worker makes in a geographical area or in the organization. Payment may be calculated as a fixed amount for each task completed or on an hourly or daily rate basis for their services.
- Wage structure is the hierarchy within a company that sets the amount for each level of employment and the benefits due to each level.
- The basic purpose of wage and salary administration is to establish and maintain an equitable wage and salary structure.
- A national wage policy aims at establishing wages at the highest possible level, which the economic conditions of the country permit and ensuring that the wage earner gets a fair share of the increased prosperity of the country as a whole resulting from the economic development.
- A pay or payment is an exchange between two parties for goods and services. It includes many forms such as barter system, money, credit/debit card, cheques, etc. In terms of compensation, payment can be calculated as a fixed amount for each task completed, on hourly basis, or based on an easily measured quantity of work done.
- A macroeconomic factor is an influential fiscal, natural, or geopolitical event that broadly affects a regional or national economy. Microeconomics is the social science that studies the implications of human action, specifically on the utilization and distribution of scarce resources.
- Wage settlement is an agreement over wages following negotiations between workers and employers. Payment of the compensation is one time settlement for a certain period of time to the employee.
- According to the Factories Act 1948, an occupier of an establishment has to ensure the health, safety and welfare of all the workers while they are at work in the factory. It is obligatory for an employer/occupier to ensure the provision and maintenance of plant and systems of work, which should be safe and without any health risks.

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1.9 KEY WORDS

- **Compensation:** It is the provided by an employer in cash to an employee.
- **SOP (Standard Operating Procedure):** A set of step-by-step instructions compiled by an organization to help workers carry out complex routine operations.
- **Survey:** It means to ask (many people) a question or a series of questions in order to gather information about what most people do or think about something.
- **Union:** It is a society or association formed by people with a common interest or purpose.

1.10 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. State the differences between intrinsic and extrinsic rewards.
2. Define wage.
3. What are the steps involved in the wage determination process?
4. Why did the National Wage Policy fail?

Long Answer Questions

1. Discuss the components and features of reward system.
2. Examine wage level and wage structure.
3. Describe wage policy in a developing economy, along with its principal constituents.
4. Evaluate the wage settlements in India in the past and present scenario.

1.11 FURTHER READINGS

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UNIT 2 WAGE AND SALARY STRUCTURE: AN OVERVIEW

Structure

2.0 INTRODUCTION

In the previous unit, you were introduced to the concept of compensation, rewards, wage levels and wage structures. This unit will give detailed information about the principles of wage and salary administration, wage theories, components of compensation and significantly the problems and prospects associated with compensation.

2.1 OBJECTIVES

After going through this unit, you will be able to:

- Understand the factors influencing wage and salary
- Describe the structure and principles of wage and salary administration
- Discuss the wage theories, along with the components of compensation

2.2 INTRODUCTION TO FACTORS INFLUENCING WAGE AND SALARY STRUCTURE

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The wage policies of different organizations vary somewhat. Marginal units pay the minimum necessary to attract the required number and kind of labor. Often these units pay only the minimum wage rates required by labor legislation and recruit marginal labor. At the other extreme, some units pay well above the going rates in the labor market.

A sound wage policy would be to adopt a job evaluation program in order to establish fair differentials in wages based upon differences in job contents. The basic factors provided by a job description and job evaluation for wage and salary administration are as follows:

- The organization's ability to pay
- Supply and demand of labor
- The prevailing market rate
- The cost of living
- Living wage
- Productivity
- Trade union's bargaining power
- Job requirements
- Managerial attitudes
- Psychological and sociological factors

2.2.1 Principles of Wage and Salaries Administration

The commonly suggested principles governing fixation of wage and salary are:

- There should be a definite plan to ensure that differences in pay for jobs are based upon variations in job requirements, such as skill, effort, responsibility of job or working conditions, and mental and physical requirements.
- The general level of wages and salaries should be reasonably in tune with that prevailing in the labor market. The labor market criterion is most commonly used.
- The plan should carefully distinguish between jobs and employees. A job carries a certain wage rate, and a person is assigned to fill it at that rate. Exceptions sometimes occur in very high-level jobs in which the job-holder may make the offer large or small, depending upon his ability and contributions.

- Equal pay for equal work, i.e., if two jobs have equal difficulty requirements, the pay should be the same, regardless of who fills them.
- An equitable practice should be adopted for the recognition of individual differences in ability and contribution. For some units, this may take the form of rate ranges, with in-grade increases; in others, it may be a wage incentive plan; in still others, it may take the form of closely integrated sequences of job promotion.
- There should be a clearly established procedure for hearing and adjusting wage complaints. This may be integrated with the regular grievance procedure, if it exists.
- The employees and the trade union, if there is one, should be informed about the procedure used to establish wage rates. Every employee should be informed of his own position, and of the wage and salary structure. Secrecy in wage matters should not be used as a cover-up for haphazard and unreasonable wage programme.
- The wage should be sufficient to ensure for the worker and his family a reasonable standard of living. Workers should receive a guaranteed minimum wage to protect them against conditions beyond their control.
- The wage and salary structure should be flexible so that changing conditions can be easily met.
- Prompt and correct payments of the dues of the employees must be ensured and arrears of payment should not accumulate.
- For revision of wages, a wage committee should always be preferred to the individual judgment, however unbiased, or a manager.
- The wage and salary payments must fulfil a wide variety of human needs, including the need for self-actualization. It has been recognized that 'money is the only form of incentive which is wholly negotiable, appealing to the widest possible range of seekers.... Monetary payments often act as motivators and satisfiers interdependently of other job factors.'

2.3 WAGE THEORIES

We talk of economics at different fronts, and therefore, it is imperative to begin the understanding of the economic world and surrounding theories with the word economics itself. The term, economics, has been derived from 'oikonomikos', which is understood as skilled in household matters or related activities. Although the word is quite conventional and old, the way economics as a discipline emerged today is a relatively modern development. Modern economic thought emerged

in the seventeenth and eighteenth centuries, primarily because of the fact that the western world began its transformation from an agrarian to an industrial society. There has been a huge difference then and now in terms of state of economic affairs and developments, but the economic problems prevailing in the society remain the same. For instance, how do we decide what to produce with our limited resources? How do we ensure stable prices and full employment? How do we provide a better standard of living for ourselves and for our future generations?

Economic developments have been closely observed, but they could initiate only detached steps rather than evolve smoothly over time. A new school of ideas suddenly emerged. It was because of the changes in the economy that gave a fresh approach and transformed the existing and outdated doctrines. The new school became popular among the majority and succeeded in having a consensus view. The hope is that the process still continues today. Its motivating force remains the same as compared to three centuries back. The motivating drive was to understand the economy so that we may use it to achieve society's goals aptly and wisely.

2.3.1 Evaluation of Theories

Ricardo's classical theory started with thoughtfulness about the national economy's combined supplies of land, labor and capital, and also to grow as long as the resulting growth of output and the real wages and profit shares of the same enabled them to continue.

Concentration was on the physical production of material goods and ratios of outputs. This basic vision brought a theory of production. It also brought a directly connected theory of income distribution or the wages, profit and land rent shares of the national output. The theory of exchange and the relative prices of the different products appeared only as the final part of the analysis.

The neoclassical theory of the economy's functioning began with consumers' requirements and evaluation of the final products. It also encompassed the demand for the final products, with special attention given to the utility analysis of the subjective background of market demands and prices, not attempted in the Ricardian classical theory. With the help of this new starting point, the neoclassical theory marched towards the opposite or reverse direction of study. From the demand prices of the different products, the new analysis derived the demand prices for the productive services. Additionally, workers, capital and land were employed in the production process, and thus, moved from the subject of 'value' to income distribution instead of the reverse. This also led to the view that all costs of production are the payments that the producers of each product have to make for the productive services which they hire and use. It either depends upon or

must equal the alternative opportunities or possible earnings of the receivers. The demands in the economy for all its different products and rival demands for the services of its limited supplies would determine both the prices of the products and those of the productive services.

2.3.2 Hypothetical Approach to Wage Theories

According to this theory, employers knew that if they pay enough to their employees, their employees would work. However, the question is whether the employer pays adequate or as per the expectations of the workers. This is where businessmen and economists share a deep and common interest. Most social reform measures were primarily carried out to meet the demands pertaining to wages. History witnessed a lot of such occurrences wherein the bone of contention was adequate wages, and to stretch the issue further instigating societal unrest was seen as an option.

Wage labor is a relatively new development in economic history. In past societies, slaves were supposed to do the basic and laborious tasks. Only the artisans in such societies had freedom in terms of high dignity and they were privileged to sell the product in terms of their labor for an apt price. However, special forms of contractual relationship appeared but overall only a few persons participated in the system. Since the beginning of the seventeenth century in Western Europe, most people were free to sell their labor to anyone who possessed the buying capacity but with a mutually agreeable price to both parties. The prominent characteristics of our economic order were the presence of the freedom of choice and wage labor. It is often said that the use of the wage system is coincidental with that of modern capitalism. The change was not immediate. In England, for a long period, wages were regulated by legislations. Gradually these controls vanished and workers started assuming responsibility for determining their own wage scales. Under the new freedom, where laborers worked for others with tools and raw materials that were not their own, the old wage tradition of just a mere wage no longer was admitted and justified. The search for new meanings, formulae and explanations were already under progress. As a result, it brought collections of theories with lot of varieties to choose from.

On most issues, the physiocrats and mercantilists had differences of opinion to a great extent, but surprisingly their views were matching so long as wages are concerned. Both agreed that wages were set at the subsistence level of laborers. In fact, the mercantilists formulated a definite theory of wages and they accepted such a theory wherein no single question is inferred from their writings on foreign trade and taxation. Charles Davenant in his discussion of foreign trade highlighted as to how a rise in the price of food items would result in a rise in the wages of workers who produce goods for export purposes thereby altering the advantage

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to England's competitors. The physiocrats affirmed the theory as more positive. Quesnay believed the wage earners received only a subsistence wage because the pressure of competition actually reduced the wages to a very low level. Turgot said that in all the cases, the industrial worker were paid only what was necessary for them to secure subsistence.

The Subsistence Theory

The subsistence theory of wages asserts that in the long-run, the real wage level will emerge to be a subsistence level, although in the short-run it may exceed this level. There are several forces which operate in this context. For instance, population is likely to increase as a consequence of increase in the real wages causing increased demand upon food supply which, in turn, will bring down the level of wages to a mere subsistence level. As this theory stresses generalization regarding the global economic system, it is in line with the macro-approach. This theory has been rejected in view of the fact that with the increasing level of income, the number of children is found decreasing rather than increasing.

Market Theories of Wage

According to Classical economists, wages, i.e., price of labor are determined (like all prices) by supply and demand. They refer to this as the market theory of wage determination. Under the condition of a perfectly labor market and a perfectly product market, wages are determined by the demand for and supply of labor. If all the units of labor are identical and if non-monetary advantages are the same in all uses, then the wage rate for each labor tends to be the same in a perfectly competitive market. In the real world, however, the labors are neither identical nor homogeneous. Nor are the different workers paid the same wage rate.

The Wages Fund Theory

The wages fund theory which has been associated with JS Mill asserts that wages were paid from a fixed fund. It was held that the lump sum had been distributed equally among the workers obtained in the labor market. Explicitly, this theory was based on short-run and macro-approaches. Although the idea of a fixed fund has some relevance today in the form of a short-term budget revenue, it has limited value because current funds can be employed for compensating the human resources.

The Labor Theory of Value

The labor theory of value or the surplus value theory is based upon Smith's assumption that the value of a particular commodity is equivalent to the magnitude of labor involved in it. Accordingly, it has been asserted that labor deserved the total value of the goods it produced. As large amounts went to profits, rents and

interests, the labor was assumed to be exploited increasingly in the capitalist system. However, history has shown opposite trends. Indeed, the misery of workers has not increased as it was assumed by Marx. Rather, their standard of living has improved with the growth of technology.

The Marginal Productivity Theory

The marginal productivity theory of wages, although initially was based on short-run analysis, is at present highly significant in determining long-run wage levels. This theory is based on the assumption of a price economy, a perfectly competitive economy, with the homogeneity and mobility of production factors, multiplicity of buyers and sellers, perfect knowledge, profit maximization as a guiding force, full employment of all factors and the law of diminishing returns. It has been argued that two men working together will produce more than two times as compared to the total amount when they produce separately Thus, initially each additional individual's contribution to the total output would be more than the total product while each is working alone. However, there will occur a point where in view of the law of diminishing returns, the output of an additional individual will be less than the preceding one. The entrepreneur will employ additional individuals beyond this point until the cost or wage of the marginal or additional individual is equivalent to the marginal individual's output. In other words, individuals will be added so long as marginal revenue product is not equal to marginal cost of the individual. Explicitly, at this point, his profits will be maximum. This theory is based on short-run and micro-approaches and examines as to why and how wage is paid stressing the demand for labor. However, as Dunn and Stephens9 lucidly indicate the theory is weak on supply side and involves circular reasoning. Notwithstanding this, attempts have been made to refine the theory by extending its applications to long-run problems.

The Bargaining Theory: Social Theories

The bargaining theory of wages assumes that wages are determined by interaction of management and labor in a collective bargaining process. Although this theory does not provide adequate analysis of source of wages in the long-run, it forms an effective basis for determining wages in the short-run.

The Investment Theory

The investment theory of wages asserts that individuals are paid in terms of their investment in the form of training, education and experience. Thus, according to this theory, wages are determined in terms of what the individuals 'bring to' a job, i.e., their investment, although practically, they are also paid in terms of their physical and mental input in the jobs.

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Human Capital Theories

Human capital is the stock of competencies, knowledge, social and personality attributes, including creativity, embodied in the ability to perform labor so as to produce economic value. It is an aggregate economic view of the human being acting within economies, which is an attempt to capture the social, biological, cultural and psychological complexity as they interact in explicit and/or economic transactions. In a way, the idea of 'human capital' is similar to Karl Marx's concept of labor power. According to Marx, in capitalism workers sold their labor power to receive income (wages and salaries). He pointed to 'two disagreeably frustrating facts' with theories that equate wages or salaries with the interest on human capital.

- The worker must actually *work*, exert his or her mind and body, to earn this "interest." Marx strongly distinguished between one's *capacity* to work, Labor power, and the activity of working.
- A free worker cannot sell his human capital in one go; it is far from being a liquid asset, even more illiquid than shares and land. He does not sell his skills, but contracts to utilize those skills, in the same way that an industrialist sells his produce, not his machinery. The exception here are slaves, whose human capital can be sold, though the slave does not earn an income himself.

An employer must be receiving a profit from his operations, so that workers must be producing what Marx (under the labor theory of value) perceived as surplus-value, i.e., doing work beyond that necessary to maintain their labor power. Though having "human capital" gives workers some benefits, they are still dependent on the owners of non-human wealth for their livelihood.

Equity or Behavioral Theories

Equity theory is a theory that attempts to explain relational satisfaction in terms of perceptions of fair/unfair distributions of resources within interpersonal relationships. This theory was first developed in 1963 by John Stacey Adams. According to Adams, employees seek to maintain equity between the inputs that they bring to a job and the outcomes that they receive from it against the perceived inputs and outcomes of others. The belief is that people value fair treatment which causes them to be motivated to keep the fairness maintained within the relationships of their co-workers and the organization. The structure of equity in the workplace depends on the ratio of inputs to outcomes. Inputs are the contributions made by the employee for the organization.

Equity theory seeks to relate employees' behavior, their perception of equity or inequity in their compensation. Elliott Jacques has been the leading advocate of the equity approach. His analysis relies heavily on his view that effective reward systems must relate pay to the level of work as defined by the time span of

discretion. This time span is the maximum period for which a job holder can be allowed to exercise discretion or self-control without a supervisor's review.

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Check Your Progress

1. What would be a sound wage policy?
2. What do you mean by 'oikonomikos'?
3. What was the main focus of Ricardo's classification theory?

2.4 COMPONENTS OF COMPENSATION

A compensation system consists of total remuneration received by an employee and this is inclusive of financial rewards (fixed and variable pay) and the benefits. Reward system also incorporates non-financial rewards such as recognition, praise, achievement, responsibility, personal growth and so on. Hence, an organization's reward system consists of financial rewards, employee benefits and non-financial compensation. Following are the main components of an organization's reward system:

- Processes adopted for measuring the value of jobs and contributions made by each employee in those jobs.
- Processes adopted to determine the level and extent of employee benefits to be provided.
- Structures put in place to link pay and benefits to the value of the position.
- Practices used for rewarding people based on their knowledge, skill and abilities.
- Practices used for motivating employees by using financial and non-financial rewards.
- Schemes and methods for rewarding performance.
- Procedures for efficient functioning of wage and salary administration.

The Oxford English Dictionary defines a system as 'a set or assemblage of things connected, associated or interdependent, so as to form a complex whole'. A reward system of an organization is precisely what the definition says, that is, a complex set of interconnected processes. For understanding the concept of reward system, we shall outline the basic elements that constitute an employee reward. An organization develops its reward system within its framework of reward philosophy, reward strategies, policies and government regulations. A typical reward system

will contain processes, procedures and structures that maintain the grades, types and levels of pay and other benefits (Figure 2.1).

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2.5 IMPLICATIONS AND PROBLEMS

Compensation and reward system plays an important role in a business organization. Person is the most important factor among four factors that is, person, material, machine, and money. The business process is unimaginable without a person. Every factor contributes to the process of the business or business strategy. A person expects the return from the business process just like rent is the return expected by the landlord, capitalist expects interest, and organizer or entrepreneur expects profits. Every labor plays an important role in bringing about the process of production or business organization. The other factors are also humane such as expectations, emotions, ambitions and egos. Labor, therefore expects to have fair share in the business strategy or production procedure. Basically, a fair compensation system is mandatory for every business organization or production company. The fair compensation system will help in the following manner:

- A perfect compensation system has an effective impact on the employees' competency and performance result. It will give them more energy for achieving the goals of the organization.
- It will escalate the process of job appraisal. It can be helpful in setting up an ideal job appraisal and the set standards would be more naturalistic and achievable.
- This system should be better interpreted and made uniform in nature. As a general system, it will be applicable to all the stages of the organization.
- The system should be very natural and flexible so that every employee would be able to enumerate his own acceptable compensation.
- It should be easy to execute and also should not be exploitative of the workers of the organization.
- It will increase the self-confidence, efficiency, and cooperation among the workers or the employees. It will provide them job satisfaction and support.
- This system will help management to comply with the several labor acts.
- This system will also solve the disputes between the employee and management authority.
- The system should follow the management principle of paying equal for equal amount of job done.
- It can motivate and encourage those whose performance are better and will provide opportunities or scope.

- Sound Compensation or Reward System brings peace in life and in the relationship of employer and employees.
- It aims at creating a healthy competition among them and encourages employees to work hard, make them feel energetic and efficient.
- This system provides growth and advancement to the deserving employees of the organization.
- The perfect compensation system provides platform for happy and satisfied workforce in the organization. This minimizes the labor turnover. The organization enjoys the stability.
- The organization is able to retain the best talent by providing them adequate compensation for stopping them from switching over to another job.
- The business organization can expand and grow only if it has the support of skilful, talented, and happy employees.
- The sound compensation system is hallmark of organization's success and prosperity. The success and stability of organization is measured with payment package.

Significance of employee compensation

The significance of personnel remuneration, either wages or salaries, is highly remarkable from the viewpoint of industrial relationships, social peace, and economic involvement. Following are some of the points which highlight the significance of personnel remuneration:

- Wages or salaries constitute the primary source of income for the employees. Their adequacy would be very much detrimental to their standard of living.
- Sufficient remuneration is a source of motivation for employees. It makes them committed and loyal to the organization and paves way for excellent industrial relations.
- By making adequate and timely payment of employee remuneration, an employer can attract and retain good personnel in the organization. This helps to ensure stability in labor force–bringing several valuable advantages in its wake for the organization.
- Especially, in labor-intensive industries, wages constitute a substantial part of the cost of production. As such wage payments affects the cost and price-structures of an industrial enterprise. Prices of goods and services, in turn, have social implications as these directly affect the purchasing power of money held by the society.

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Suitability of piece rate system

Piece rate system of wage payable amount is suitable under the following cases:

- The quantity of work is more crucial than quality of work done by the employee, where production has a standard nature.
- Efforts and rewards could be simply analogized, where the work has a private nature.
- When the work is of a standardized nature, then the standard work, standard time, and standard methods of performance could be easily ascertained.
- Where, in an organization, there is no proper system of supervision over workers.
- Where workers have a tendency to shirk work.
- Where record-keeping for labor cost is needed imperatively, for costing purposes.
- Where there is a scope for more work on the part of workers within the facilities provided for production and time allowed for production purposes. (Piece rate system would drive them towards more production).

2.5.1 Problem or Issues of Employees Compensation

Even the most sophisticated employers make mistakes; among the most repeated errors include the following issues:

- One of the mistakes include using one inclusive job title to apply for multiple different duties and responsibilities and compensating for the responsibility level. Whether this situation arises from laziness, by design, or simple error, this can result in major workplace disruption. While it is smart business to compensate fairly for your market and staff responsibility levels you expect the employee to embrace, it is unrealistic to expect that co-workers, working under an identical job title, will express joy that a perceived peer receives higher compensation. Many forward thinking companies have created new 21st century titles to avoid this mistake. For example, some employers now have a CMO (Chief Marketing Officer), CCO (Chief Creative Officer), or COSO (Chief Online Services Officer) title to differentiate responsibilities from titles. Even in the C-level suite, smart employers try to avoid job title/ responsibilities conflicts.
- Failure to associate incumbent compensation with levels offered to new hires is another mistake. Some hiring managers become overly enamored with sought-after candidates and offer compensation that has little relevancy

to the current staff earning structure. Should this information become non-confidential, the current high performing employees will become very dissatisfied with their jobs and their employers.

- While there are some strong federal regulations addressing the improvement of formal benefits, outside of some intimidating union contracts, there are few mandates regarding salary or incentive rewards. However, regardless of how confidential individual compensation records may be, information can easily spread at the workplace or the organization.

2.5.2 Prospects or Opportunity of Compensation

The compensation involves the following prospects:

- Career growth or great opportunities
- Attractive competitive salary with multiple bonus opportunities for the employees
- Paid overtime (time and a half for all hours over 40)
- 10 days paid vacation and 7.5 days paid personal time per year (start accruing immediately)
- Paid continuing education
- 100% paid health and dental care for the employee (group rates for dependents paid by the employee)
- 100% paid life insurance (group rates for additional coverage paid by the employee)
- Short term disability that offered at group rates paid by employee
- Free parking zones
- Flexible time

Management must communicate frankly with staff regarding their compensation policy. Fairness and adhering to the policy is important as they are the individual components of the organization. Still, there are mistakes being made by the employers of the company. Minimizing potential errors is both possible and crucial to a satisfied, better performing staff, and operational efficiency.

Check Your Progress

4. What does a typical reward system contain?
5. State any two cases when the Piece rate system of wage is suitable.
6. List any three prospects associated with compensation.

2.6 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

NOTES

1. A sound wage policy would be to adopt a job evaluation programme in order to establish fair differentials in wages based upon differences in job contents.
2. The term, economics, has been derived from 'oikonomikos', which is understood as skilled in household matters or related activities.
3. The Ricardo's classical theory concentrated upon the physical production of material goods and ratios of outputs.
4. A typical reward system will contain processes, procedures and structures that maintain the grades, types and levels of pay and other benefits
5. The Piece rate system of wage is suitable under the following cases:
   (a) The quantity of work is more crucial than quality of work done by the employee, where production has a standard nature.
   (b) Efforts and rewards could be simply analogized, where the work has a private nature.
6. Compensation involves the following three prospects:
   (a) Career growth or great opportunities
   (b) Attractive competitive salary with multiple bonus opportunities for the employees
   (c) Paid overtime (time and a half for all hours over 40)

2.7 SUMMARY

- The wage policies of different organizations vary somewhat. A sound wage policy is to adopt a job evaluation programme in order to establish fair differentials in wages based upon differences in job contents.
- Modern economic thought emerged in the seventeenth and eighteenth centuries, primarily because of the fact that the western world began its transformation from an agrarian to an industrial society. There has been a huge difference then and now in terms of state of economic affairs and developments, but the economic problems prevailing in the society remain the same.
- Compensation and reward system plays an important role in a business organization. Person is the most important factor among four factors that is,

person, material, machine, and money. The business process is unimaginable without a person.

- The significance of personnel remuneration, either wages or salaries, is highly remarkable from the viewpoint of industrial relationships, social peace, and economic involvement.
- Still, there are mistakes being made by the employers of the company. Minimizing potential errors is both possible and crucial to a satisfied, better performing staff, and operational efficiency.

2.8 KEY WORDS

- **Physiocrats:** Believers in Physiocracy, a theory of wealth, led by Quesnay, believed that the wealth of nations was derived solely from the value of agriculture
- **Reward policy:** It is a statement which is developed by organizations to act as a guideline for managing the reward processes.
- **Pay:** It is a contractually agreed regular monetary reward, paid as salary or wages and is related to a position or job.

2.9 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. What are the basic factors provided by a job description and job evaluation for wage and salary administration?
2. What are the main components of an organization's reward system?

Long Answer Questions

1. Discuss the principles of wage and salary administration.
2. Describe the different wage theories, developed over time.
3. Evaluate how a fair compensation system is helpful?

2.10 FURTHER READINGS

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UNIT 3 MINIMUM WAGES: AN OVERVIEW

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Structure

3.0 INTRODUCTION

The Minimum Wages Act 1948 is the Act of Parliament that sets the minimum wages that must be paid to skilled and unskilled labours. The Indian Constitution has stated a 'living wage', which is the level of income ensuring a basic standard of living including good health, dignity, comfort, etc. However, the Constitution has defined a 'fair wage', keeping in mind an industry's capacity to pay. Fair wage is that level of wage that not just maintains a level of employment, but seeks to increase it.

An employee contributes to the accomplishment of his organization's objectives with his skill, time, and effort in return of money, goods and services. He views the reward as 'value'. An employee's needs, therefore, go hand in hand with the goals and objectives of the organization. The main objective of this unit is to introduce you to the concepts of minimum wage, keeping in mind the symbiotic relationship between the organization and its employees.

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3.1 OBJECTIVES

After going through this unit, you will be able to:

- Understand the concept of minimum wage and salary
- Describe the kinds and elements of a wage plan
- Discuss the wage fixation factors

3.2 INTRODUCTION TO MINIMUM WAGES

The idea of minimum wage regulation was first developed in New Zealand and Australia and gradually became popular in the rest of the world. There are three kinds of minimum wage:

- The minimum wage notified by the government under the Minimum Wages Act, 1948 for different scheduled employments.
- Need based minimum wage determined as per the norms prescribed by the 15th session of Indian Labour Conference.
- The minimum wage drawn by an unskilled worker in an organized industry as a result of a wage settlement which is purely the result of hard or, at times, coercive bargaining.

The standards and contents of minimum wage keep changing with the state of the economy. In other words, the level of minimum wage is basically dynamic and not fixed and static. The International Labour Organization has fixed the following three criteria for establishing the minimum wage:

- The needs of the workers
- The capacity to pay
- Wages paid for comparable work elsewhere in the economy or more generally the standard of living of other social groups

According to the Committee on Fair Wages (1948), in India, the considerations are different when it comes to establishing minimum wages. In foreign countries, the criteria for establishing the living wage forms the basis of fixing the minimum wage. This rule could not be followed in India as the level of national income was so low that it was not possible to fix a minimum wage which would correspond to the concept of living wage. The committee observed that the minimum wage should be such that it must not only provide sustenance but must also preserve the efficiency of the worker. Apart from sustenance and efficiency, a measure of education, medical requirements and amenities must also be provided through the minimum wages. In the Indian context, a distinction has to be made between bare subsistence or minimum wage and a statutory minimum wage. Bare subsistence

wage refers to a wage level which guarantees to fulfil only the bare subsistence needs of the worker and his dependents. The statutory minimum wage, on the other hand, is the minimum wage established by a statute and it may be higher than the minimum wage.

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Check Your Progress

1. Define fair wage.
2. What are the three criteria for establishing the minimum wage?

3.3 INTRODUCTION TO BASIC WAGE PLANS

Wage incentive refers to performance linked compensation paid to improve motivation and productivity. It is the monetary inducement offered to employees to make them perform beyond the accepted standards. Following are the types of wage incentive plans discussed in detail.

3.3.1 Straight Piece Rate Plan

Under the Straight Piece Rate Plan, workers are paid based on their output. For example, if the piece rate is ₹ 4 per piece of the product, then a worker who turns out 40 pieces/day earns ₹ 160 (₹ 4 x 40) as their wage for that day, whereas another employee who produces 32 pieces/ day earns ₹ 128 (₹ 4 x 32 pieces). Hence, a fast worker earns more compared to the slow worker. Its advantages are:

- Motivates the workers to increase their output
- Simple and easy to understand.
- Improve productivity

Its disadvantages are:

- No guaranteed minimum wage. This makes workers feel insecure.
- Great disparity of earning between slow and fast workers
- Wastage might increase
- Quality of production may suffer as the workers concentrate on quantity.
- Interpersonal relationship suffers due to jealousy and competition to earn more.
- Enforced idleness like electricity failure or machine breakdown, adversely affect earning of workers.

3.3.2 Standard Piece Rate with Guaranteed Minimum Wage

As the name suggests, in Standard Piece Rate with Guaranteed Minimum Wage, the minimum guaranteed wage is fixed on hourly basis. A worker gets the minimum

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fixed wage per day plus the incentive for the number of pieces produced. To illustrate this, assume that there is an 8 hours' shift and the piece rate is Rs 4. So, a minimum fixed wage of Rs 16/ hours will be equal to ₹ 128 per day (Rs 16 x 8 hours = ₹ 128 per day). The standard time/piece is 15 min. Now, there are two workers A and B. (If worker A produces 25 pieces/day then he earns ₹ 128 (min. guaranteed wage) + ₹ 100 (₹ 4 x 25 pcs) = ₹ 228/ day. If worker B produces 40 pieces/day then, he earns ₹ 128 (min. guaranteed wage) + ₹ 160 (40 pieces x ₹ 4) = ₹ 228/ day.

Its advantages are:

- Minimum guarantee improves sense of security.
- Disparity between slow and faster workers is reduced

Its disadvantages are:

- Demotivate faster worker
- Slow workers get higher piece rate namely ₹ 5.12 (128/ 25).

3.3.3 Differential Piece Rates

The shortcoming of the above mentioned incentive plans have given way to Differential piece rates. The differential piece rates are classified under two heads namely, Individual incentive plans and Group incentive plans.

Individual Incentive Plans: The different plans here are discussed below:

(a) Halsey Plan: Minimum wage is guaranteed. Additional bonus is provided to workers who complete the job in less than the 'standard time'. Bonus is a certain proportion to the time saved. This proportion is fixed at 50% in this plan. The total wage is calculated as:

$$\boxed{T \times R + 50\% (S - J) \times R}$$

Where J–time taken

R–Rate of wage

S–Standard time

50%–The bonus percentage

Its advantages are:

- Guaranteed minimum wage
- Simple and easy
- Not time consuming and freedom from costly process of work study
- Management share a part of bonus on time saved.

Its disadvantages are:

- Workers get only half of the benefit of their efficiency.

- If the workers rush through the job to save time, the quality may suffer.
- Workers object on sharing the bonus on time saved with the management.
- Sufficient incentive is not provided to fast workers.

(b) Rowan Plan: This is a modified form of Hasley Plan, developed by James Rowen of England. The Rowan Plan pays more than the Halsey Plan. This is possible, if a worker completes the task in half the standard time of the task. If more than 50% time is saved then the bonus he earns decreases. Therefore,

$$\boxed{\text{Total wage} = J \text{ x } R + [J \text{ x } R \text{ x } (\text{Time saved/std. time})]}$$

Its advantages are:

- Minimum guaranteed wage
- Both the employees and the workers share the benefits of time saved.
- The efficient workers get bonus at diminishing rate, if they save more than 50% of the standard time. This checks over-speeding and quality.

Its disadvantages are:

- Incentive provided for fast worker is not sufficient.
- Workers dislike management sharing the bonus of time saved.

(c) Gantt plan: This plan was developed by Henry L. Gantt. In Gantt plan, standard time for every task is fixed through time and motion study. Minimum time wage is guaranteed to all workers. A worker who fails to complete the task within the standard time receives wages for actual time spent at the specified rate. Workers, who achieve or exceed the standard, get extra bonus varying between 20% and 50% of the hourly rate for the time allowed for the task.

Its advantages are:

- Minimum wage guaranteed
- Fast worker is paid bonus at higher rate proportional to their output.
- Standard worker is paid 20% bonus.
- Part of bonus is shared by the organisation.

Its disadvantages are:

- Sharing of bonus by organisation leads to resentment among workers.
- Disunity among the slow and the fast workers.

(d) Bedaux Plan: This plan is developed by Charles E. Bedaux in 1911. In Bedaux plan, the minimum wage is guaranteed to all workers. The workers

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who complete the job within or more than the standard time are paid at the normal time rate. Workers, who complete the job in less than the standard time, are paid bonus, generally 75% of the wage for the time saved and 25% to the foreman. The wage rate is calculated as:

$$\boxed{S \times R + 75\% \text{ of } R\,(S - T)}$$

Its advantages are:

- Minimum wage is guaranteed to all the workers.
- The foreman is motivated to produce as 25% of time saved is paid to him.
- This plan is suitable in factories, wherein a worker is expected to perform different types of jobs.

Its disadvantages are:

- Workers may resent sharing the bonus with foreman.
- Workers may find it difficult to understand the complete calculation involved in this method.

(e) Emerson's Efficiency Plan: This plan was developed by Harrington Emerson. In Emerson's Efficiency Plan, minimum wage is guaranteed. Workers are paid different bonus rates as per their efficiency level. Bonus is given at an increasing percentage beyond the prescribed level of efficiency (usually 66.67%). Efficiency is measured by comparing the actual time taken and the standard time.

Its advantages are:

- Guaranteed wage provides a sense of security to all the workers.
- It encourages healthy competition among workers.
- Bonus begins at 66.67% efficiency, which is within the reach of many workers.

Its disadvantages are:

- There is little incentive after 100% efficiency level.
- The plan is not very flexible or selective.
- Employer could fix the standard time at a low level making it impossible for most of the workers to earn bonus.

Group Incentive Plan

In some cases like an assembly line production, it is not possible to determine the performance of an individual worker as several workers jointly perform a

single operation. In such cases, it is desirable to introduce a group incentive scheme. Here, the bonus is calculated for a group of workers and the total amount is distributed among the group members in proportion to the wage earned by each.

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a. **The Scalar Plan:** This is a group plan, where the productivity of the entire work force is taken into account. In this plan, bonus is paid at the rate of 1 % for every 1% rise in productivity. Workers are not paid the full amount of bonus earned by them in the same month. A certain percentage is set aside as a 'Resource Fund' to take care of fluctuation. At the end of the year, the balance remaining in the 'Reserve Fund' is distributed.

b. **Priest Man Bonus Plan:** Here, a committee of workers and management set the standard of performance. A minimum wage is guaranteed to each worker. The group gets bonus, when actual output exceeds the standard. The group supervisor also gets a share on the group bonus. This plan promotes team spirit among employees.

Check Your Progress

3. List the advantages of Straight Piece Rate Plan.
4. What are the cases in which group incentive scheme are appropriate?
5. How are the differential piece rates classified?

3.4 INTRODUCTION TO WAGE DIFFERENTIALS

Wage differentials are closely interlinked with the wage system. This association has been widely recognized and acknowledged by academicians and industrial organizations. Wage differentials have an impact on the economy in terms of resource allocation, national income generation, and socio-economic welfare activities. Wage differentials are important because they reflect the differences in various economic factors, such as the ability of workers, the efficiency of industrial managements and consumer choices. Most importantly, they affect the factor market in terms of labour mobility.

To emphasize the importance of wage differentials, we quote from Harry Ober's observations on wage differentials:

> Occupational differentials in wage rates are generally recognized as vital to the existing system of wages. Not only do they make possible compensation in accordance with skill, effort and working conditions, but they are necessary to ensure a sufficient supply of skilled and trained workers. To the worker in a particular occupation, wage differentials mean additional income for more arduous or skilled performance. Differentials also indicate differences in craft or trade prestige.

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Noting the importance of wage differentials for the economy, the Committee on Fair Wages recommended that wage differentials be established on the basis of certain considerations. They are as follows:

- The degree of skill
- The strain of work
- The experience involved
- The training required
- The responsibility undertaken
- The mental and physical requirements
- The disagreeableness of the task
- The hazard attendant on the work
- The fatigue involved

3.4.1 Factors Contributing to Wage Differentials

According to Robert E. Sibson, the following factors contribute to the presence of wage diversity in a wage system:

- The difference in the earnings and the earning capacity of the employee
- The personal policy of the employer
- Factor or labour market imperfections
- Regularity of employment
- Job security
- The collective bargaining strength of the labour unions *vis-à-vis* the organization
- The employers' valuation of the labour
- The proportion of total costs represented by labour costs
- The position of the employer's product in the market
- Variations in the performance of the individual
- The percentage of fringe items in a worker's compensation
- Inherent job disutility and hazards connected with specific jobs

Apart from the above-mentioned factors, there are other broad factors which contribute to the presence of wage differentials. They are as follows:

- The level of skill and kind of training required to perform an assigned job
- The nature of the job

- The physical and mental effort required to perform the job
- The disagreeableness of the assigned task
- The differences in efficiency levels of the workers
- The demand and supply of a specific kind of labour
- Existence of non-competing groups due to difficulties in the way of labour mobility from low paid to high paid employment
- Social prestige attached to the job.
- Ignorance of prevailing wage rates.
- Influence of customs and sociological factors
- Prevalence of different modes of payment
- Gender

Following are the factors which determine the extent of wage differentials:

- Conditions prevailing in the factor market
- The extent of unionization
- The collective bargaining capacity of the workers and their employers
- The productivity growth rate
- The extent of regulations and the degree of centralization of the process of decision-making
- Local customs and sociological factors
- The economic condition of the country
- The prevailing rate of wages
- The capacity of an industry to pay
- The requirements of social justice

Check Your Progress

6. Why are wage differentials important?
7. Mention any three consideration on the basis of which wage differentials are established.

3.5 GOOD WAGE PLAN AND WAGE FIXATION FACTORS

There are various elements associated with a good wage plan. A good wage plan need to focus on everything from job and personnel to the company itself. The wage fixation process needs to take into account the factors, which influence a

specific job and the people working in that job, along with the organization. These factors are discussed in detail in the following sections.

3.5.1 Job Factor

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A new survey by Career Builder explores the job factors that employees are looking for in their companies. Out of 3,900 respondents, they found that 32 percent of companies have reported that top performers left their organization in 2012. These days, companies are using social networks like LinkedIn, to steal talent and leverage their current employee base to expand. Another reason why companies need to increase their retention rates is because they have to build a pipeline of future leaders. Eventually, Boomers will retire, and if they don't have the next generation of talent lined up, they will struggle. Here are the top five job factors employees want now, based on the study:

(a) **Salary is more important to workers than titles:** 88 percent of workers said that salary matters more than a title and 55 percent said having a certain title is not important. This shows that employees view their salary as a success metric instead of the title. This is because in start-ups, titles do not mean anything because there are so few people, while in big companies there are so many people with the same title that it becomes insignificant.

(b) **Having a flexible work schedule:** 59 percent of employees want to be able to maintain a flexible work schedule in order to fit personal activities into their lives. If companies force employees to do work outside the working hours, then they should allow them to perform personal activities inside the office. Some employees have children too and they need to be a parent, not just an employee.

(c) **Being able to make a difference:** 48 percent of employees want to make an impact at work. Workers, especially millennial, want to see that their responsibilities matter and can affect not just the bottom line of the company, but also society. When workers have a sense of meaning in their lives, they perform better and stay longer. When workers just focus on routine tasks, they get bored, aren't proud of what they do, and end up leaving.

(d) **Challenging work:** 35 percent said that they want challenging work. Unless workers are constantly pushed to do more and take on more responsibilities, they get bored and eventually leave (especially millennial). When every workday is the same, it's hard to get any enjoyment out of what you do. Employers should constantly push workers to get the most out of them, which in effect, will challenge and help retain the top performers.

(e) **Ability to work from home:** 33 percent said they want to work from home instead of having to come to the office every day. In a recent article in

the Globe and Mail, one executive said 'We do not make people punch time cards. A job should be measured based on results not where and when you do work.'

3.5.2 Personnel Factor

The important factors of Human Resource Management are:

(a) **Business and HR alignment:** Aligning human resources practices with business philosophy is one of the most important aspects of human resources management.

(b) Talent Management.

(c) Employee Engagement.

(d) Future human resource and business goals.

3.5.3 Company Factor

The important company factors, influencing wage fixation include:

(a) **Ability to pay:** The small companies cannot pay on par with big companies. The smaller companies can only try to survive in the competitive market and sometimes end up paying even less than the standard.

(b) **Business strategy:** The strategy of a business often influences the pay of the employees. If the organization is interested in skilled workers then they will try to attract them with good salary. On the other hand, if adding skill is not important for the organization, then they will pay less.

(c) **Employee:** The employee or a worker is an important factor, when it comes to wage fixation. Their performance, experience, and potential often decides their pay and sometimes even raise the standard.

Check Your Progress

8. Why do companies need to increase their retention rates?
9. What should be the focus of a good wage plan?

3.6 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Fair wage is that level of wage that not just maintains a level of employment, but seeks to increase it.
2. The three criteria for establishing the minimum wage are:
   (a) The needs of the workers
   (b) The capacity to pay

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(c) Wages paid for comparable work elsewhere in the economy or more generally the standard of living of other social groups

3. The advantages of Straight Piece Rate Plan are:
   (a) Motivates the workers to increase their output
   (b) Simple and easy to understand.
   (c) Improve productivity
4. The group incentive scheme is appropriate in the cases like an assembly line production, where it is not possible to determine the performance of an individual worker as several workers jointly perform a single operation.
5. The differential piece rates are classified under two heads namely, Individual incentive plans and Group incentive plans.
6. Wage differentials are important because they reflect the differences in various economic factors, such as the ability of workers, the efficiency of industrial managements and consumer choices.
7. The consideration on the basis of which, wage differentials are established are:
   (a) The degree of skill
   (b) The strain of work
   (c) The experience involved
8. The companies need to increase their retention rates because they have to build a pipeline of future leaders. Eventually, Boomers will retire, and if they don't have the next generation of talent lined up, they will struggle
9. A good wage plan should focus on everything from job and personnel to the company itself.

3.7 SUMMARY

- The Minimum Wages Act 1948 is the Act of Parliament that sets the minimum wages that must be paid to skilled and unskilled labours. The Indian Constitution has stated a 'living wage', which is the level of income ensuring a basic standard of living including good health, dignity, comfort, etc.
- The idea of minimum wage regulation was first developed in New Zealand and Australia and gradually became popular in the rest of the world.
- Under the Straight Piece Rate Plan, workers are paid based on their output. As the name suggests, in Standard Piece Rate with Guaranteed Minimum Wage, the minimum guaranteed wage is fixed on hourly basis.
- The shortcoming of the above mentioned incentive plans have given way to Differential piece rates. The differential piece rates are classified under two heads namely, Individual incentive plans and Group incentive plans.

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- Wage differentials are closely interlinked with the wage system. Wage differentials have an impact on the economy in terms of resource allocation, national income generation, and socio-economic welfare activities.
- There are various elements associated with a good wage plan. A good wage plan need to focus on everything from job and personnel to the company itself.

3.8 KEY WORDS

- **Statutory minimum wage:** It is the minimum wage established by a statute and it may be higher than the minimum wage.
- **Living wage:** The highest level of the wage and includes all amenities which a citizen living in a modern civilized society expects when the economy of the country is sufficiently advanced and the employer is able to meet the expanding aspirations of his workers.

3.9 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. What are the different kinds of minimum wage?
2. Write a short note on group incentive plans.
3. State the important company factors influencing wage fixation.

Long Answer Questions

1. Describe the different types of individual incentive plans.
2. Discuss the factors contributing to wage differentials.
3. Explain various job factors which influence the wage fixation.

3.10 FURTHER READINGS

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UNIT 4 TRADE UNIONISM

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Structure

4.0 INTRODUCTION

A trade union is essentially an organization whose membership consists of workers and union leaders, who are united to protect and promote their common interests. This unit will examine the definition of trade unions, the history of trade unions in India, as well as the features and functions of trade unions. The unit will also discuss the competition factors, along with the price levels.

4.1 OBJECTIVES

After going through this unit, you will be able to:

- Understand the concept of Trade Unionism
- Describe the features and functions of trade unions
- Discuss the competition factors along with the price levels.

4.2 INTRODUCTION TO TRADE UNIONISM

When a group of employees come together to form an organization with the sole purpose of ensuring and securing various benefits for the employees, it is known as a trade union. It is a continuous association of laborers who earn wages, aimed maintaining and improving their working conditions and living standards. The Trade

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Union Act 1926 defines a trade union as a 'combination, whether temporary or permanent, formed primarily for the purpose of regulating the relations between workmen and employers or between workmen and workmen, or between employers and employers, or for imposing restrictive condition on the conduct of any trade or business, and includes any federation of two or more trade unions.'

This is a complete definition as it covers the associations of workers as well as employers and the federations of their associations. Here, both temporary and permanent relationships are taken into account. Therefore, it is applicable to employees who are working on contract as well. The three main relationships outlined in this definition are:

- Between workmen and workmen
- Between workmen and employers
- Between employers and employers

Therefore, a trade union is a unified group of employees belonging to a specific industry or sector, whose purpose is to negotiate with employers for better pay, job security, leaves, working hours, etc. To do this, they bank on the collective power of the members of the group. Simply put, a union represents the interests of its members, and may even engage in political activity, where legislation affects their members. Trade unions can be said to be voluntary associations aimed at protecting the economic, political and social interests of their members. Therefore, they have the welfare of their members in mind.

4.2.1 Characteristics of Trade Unions

The main characteristics of trade unions include:

- Trade union are associations comprising employers or employees or of independent laborers/workers. They may comprise :
- Employers' association (e.g. Employer's Federation of India, etc.)
- Labor unions in general
- Friendly societies
- Unions of intellectual labor (for example, All India Teachers Association)
- Trade unions are formed on a continuous basis. They are neither casual nor temporary, but permanent bodies that exist throughout the year.
- Trade unions are formed to promote the economic, political and social interests of their members. Their main concern is, however, economic.
- Collective action and team work is their main strength. They are able to negotiate better collectively and have more bargaining power as a group.
- Trade unions developed and progressed rapidly since their initiation. Despite their main focus being the economic benefits of workers, they have managed to work towards increases the status of workers as an important component of industry.

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4.2.2 Objectives and Importance

It is clear to all that the very purpose of trade unions is to protect and promote the interests of their members. Their main aim is to ensure that workers are not discriminated against and do not have to suffer injustice or unfair labor practices. Some of their activities include:

I. **Representation:** Trade unions also represent individual workers in case they face some issue or complexities at work. If an employee complains of being ill-treated or of injustice, he can request the trade union to intervene and sort out the issues with the managers or employers. Legal representation is also offered to members, usually to help them obtain financial assistance for treatment of work-related injuries or legal assistance in cases where they have to take their employer to court.

II. **Negotiation:** When representatives of the trade union discuss matters that affect the workers, with the management of an organization, it is called negotiation. When differences arise between the employers and the employees, who are members of the union, negotiations help to arrive at a solution to these differences. Salaries/wages, hours of work, leaves and alterations in working practices are the types of issues that usually require negotiation. Some workplaces enter into a legal agreement involving the management and the union, clearly saying that the union has the right to negotiate with the employer. In such organizations, it is accepted that the unions are meant for collective bargaining.

Voice in decisions affecting workers

The wages and employment period are not the only factors that determine the economic security of employees. It is also determined by the human resource policies of the management. These policies cover the identification of employees for layoffs, retrenchment, promotion and transfer. These policies have a direct impact on the workers. The criteria for evaluating decisions of this sort may be unfair, in which case, workers can rely on the unions to intervene so that the workers are allowed to voice their opinions before decisions are taken, so that their interests are safeguarded.

Member services

Over the years, trade unions have begun to offer all kinds of assistance to their members including the following:

(a) **Education and training:** A majority of the trade unions conduct courses for their members to train them on employment rights, and issues related to health, safety, etc. Some unions also train members professionally, especially those members who have not had much of formal education. Such members are taught basic skills and made professionally qualified.

(b) Legal help: In addition to providing legal advice on employment issues, certain unions provide assistance in personal matters, such as housing, wills and debt.

(c) Financial discounts: Union members have the chance to avail discounts on loans, mortgages, insurance, etc. from unions.

(d) Welfare benefits: Originally, trade unions were meant for ensuring that their members were well taken care of during crises or troubled times. Members are often able to get monetary help from these unions in case of unemployment of medical emergencies.

Reasons for joining trade unions

Significant issues that force employees to join a union are as follows:

I. Better bargaining power: As a single person, an employee lacks the power to bargain with his employer. If he feels he has been deprived of fair wages or working conditions, he is forced to quit his job. But then, giving up a job is not always the solutions to such problems. After all, how many jobs can an employee change? But if he continues to work half-heartedly, the job will soon become a burden for him. His stress level will increase. On the other hand, if he is the member of a workers' he can take action against the employer as a group. The union can threaten to go on strike causing the employer to give in to the workers' demands for better employment conditions.

II. No discrimination: Decisions pertaining to pay, work, transfer, promotion, etc. are very subjective. These decisions may be influenced by the personal/ individual equation or bond that exists between the supervisors and those working under them. Favoritism may also lead to discrimination. It is possible for trade unions to get the management to frame HR policies that treat all workers equally. All management decisions are closely examined by the workers' unions, which ensures there is no favoritism or discrimination.

III. Sense of security: Workers may seek membership of unions as they believe the unions offer them security and protection from work-related accidents, injuries, and also medical issues, unemployment, etc. The trade unions ensure that workers get retirement benefits and also see to it that the management invests in welfare services that are beneficial for the workers.

IV. Sense of participation: If the employees wish to be active participants in the management of issues that affect their own interests, they have to be part of trade unions. Only then can they hope to have the power to influence management's decision making. This is because, as members of the union, they have the power of collective bargaining.

V. Sense of belongingness: Most workers join unions merely because their friends or peers are already members. Peer or group pressure forces them to join, as they are afraid to be treated as outcasts or looked at differently because of their non-association with the union. As members of a union,

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workers are respected by their co-workers. Membership of the union also allows workers to freely discuss their issues with the union leaders and members.

VI. **Platform for self-expression:** Human beings seek ways to express their feelings, thoughts, emotions and ideas with each other, therefore, it is natural for workers to wish for the management to pay heed to them. This is made possible by trade unions that give a platform to these workers to discuss their thoughts and opinions and share their ideas. These ideas and opinions can then be passed on to the management. The management has little option than to pay attention to the collective voice of the workers. And they are forced to take into consideration the workers' opinions and demands while framing policies or taking important decisions.

VII. **Betterment of relationships:** Employees believe that unions are capable of facilitating proper employer–employee relations. They help in enhancing industrial relations between the management and the workers through peaceful resolution of issues.

Importance of trade unions

Industrial peace can be ensured if there exists a strong trade union which is also recognised. Collective bargaining and negotiations undertaken by unions have more power and influence. It is the trade unions that ensure proper communication between the management and the employees. They take necessary steps to prevent conflicts or disputes by working towards smoothening out differences between the management and workers. The unions are representatives of the workers in any industry, and strive to protect their interests. They are also instrumental in getting relevant courses organized for training their members on important subjects. Their efforts are focused on seeking a safe, secure and healthy working environment for all their members.

As mentioned earlier, a worker on his own cannot stand up for his rights nor have himself heard. But as a member of a strong group, his voice and demands can reach the ears of the management. Therefore, the unions are important for many reasons including the following:

- Trade unions make collective bargaining possible. Industries that have trade unions boast of better wages and remuneration. Their collective bargaining and negotiating power makes it possible for them to enjoy better terms and conditions of employment and a healthier working environment.
- Trade unions are able to strongly negotiate for better labour and industrial legislation. It is an asset for the workers and their families to have the unions representing them. Even political parties approach them with offers of attractive pro-labour laws. As a result, they are able to enjoy better medical facilities, welfare schemes, leave policies, insurance and other benefits.
- Trade unions can provide more job security for its members than the sectors where workers are not organized under a group or union.

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- Workers can rely on legal assistance from unions in case they face police action or legal complications.
- Factory workers with union membership are much better off when it comes to accidents at work. Also, unions force the employers to implement better safety measures and enforce laws that regulate such safety measures.
- Trade unions ensure that their members are never physically or mentally ill-treated at work by their managers or superiors.
- The rights of the workers are well protected by trade unions, which is a big advantage especially for women workers, who often face sexual harassment at the workplace.
- In many countries, trade unions also take care of the training, education and skill upgradation of their members.
- In issues related to increase in productivity, trade unions can negotiate with the management for a mutually favorable decision. For instance, if the demand is high, and hence more production is required, the trade unions can bargain for better compensation so that the employers are happy with productivity and employees are happy putting in extra effort.
- The assurance of protection from the trade unions keeps the workers motivated at all times as they are sure that their need— economic, social and political — will be taken care of.

Trade unions contribute to the acceleration of the speed of economic development:

- By playing a part in the hiring process
- By ensuring discipline among the workforce
- By settling industrial disputes in a rational way
- **By ensuring social adjustments:** Since workers from varied backgrounds and organizations are required to adapt to new working conditions, rules and policies, they may feel quite lost at first. It is the trade unions that help them organize themselves and settle down comfortably.
- Trade unions are an integral component of the society. Therefore, they should also have the greater good of the society and nation in mind. Their responsibilities towards the society include the following:
    1. Ensuring national integration by keeping industrial conflicts and disputes in check
    2. Incorporating a sense of corporate social responsibility in workers
    3. Achieving industrial peace

4.2.3 Functions of Trade Unions

Negotiating for better wages and allowances is the main function of a trade union. Using their collective bargaining power, trade unions also ensure better working conditions for workers. They also rely on pressure tactics, such as strikes, to

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maintain the right relationship between employees and the employers. They work to protect the interests of the workers. The functions of trade unions can be broadly classified as follows:

I. **Militant Functions:** This function includes activities that help workers have a better position at their workplace. These activities are aimed at ensuring for the workers fair wages, comfortable work conditions, better treatment from employers, etc. If these things are not achieved through collective bargaining and negotiations, they resort to other drastic measures, such as going slow, calling a strike, planning a gherao, etc. Not surprisingly, these functions are also called militant or fighting functions. Therefore, the militant functions of trade unions help achieve the following for the workers:
   - Higher wages
   - Improved working conditions
   - Better status as a part of industry
   - Protection against unfair practices/injustice and victimization

II. **Fraternal Functions:** These activities by trade unions are aimed at helping members during crises and to improve efficiency. Trade unions promote a spirit of cooperation and friendly industrial relations, for which they educate their members and try to foster a suitable culture. The morale of the workers is kept up through various welfare measures. These activities also instil self-confidence in the workforce. They also arrange to provide legal assistance to members, if a situation so requires. The welfare measures undertaken as part of fraternal functions include schools for children, library, reading-rooms, provision for sports/games, and other recreational activities, etc. Some trade unions even publish their own newsletters and magazines. Of course, a great deal of these activities are dependent on the funds available. Funds are collected via membership fee, donations from external entities and through the competency of their leaders. Thus, the fraternal functions of trade unions help achieve the following for the workers:
   - Improvement of morale
   - Generation of self-confidence
   - Sincerity and discipline among workers
   - Growth opportunities
   - Protection against discrimination (especially to women)

Check Your Progress

1. How does the Trade Union Act 1926 define a trade union?
2. State any two kinds of assistance offered by a trade union to its member.
3. What is negotiation?

4.3 TRADE UNIONISM IN INDIA

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In India, the pace of development of trade unions was rather slow as compared to the West. Indian trade union movement can be divided into three phases.

Phase 1: 1850 to 1900

This is the period when the concept of trade unions took root in the country. It was a time of long working hours, poor working conditions and unsatisfactory living conditions of the labor class. It was a time when capitalists were focused on the productivity and profits alone. This period was characterized by low wages and poor economic conditions in general. The Indian Factories Act, 1881 was brought into force with the aim of regulating the working hours working conditions of the Indian textile workers. During this period, the trade union movement grew slowly. The innumerable strikes that were called in the 1880s and 1890s across the country in the industrial cities gave the workers a taste of what collective and united action could achieve. And that too, when there was no formal union movement. By then small associations, such as the Bombay Mill-Hands Association sprung up.

Phase 2: 1900 to 1946

During this period many organized trade unions were developed and political movements of the worker class began. Several unions were born from 1918 to 1923 in India. The spinners' union and weavers' unions were organized in Ahmedabad. These occupational unions called a strike led by Mahatma Gandhi, which took the form of Satyagraha. These unions went on to become an industrial union — the Textile Labor Association in 1920. The same year, the first national trade union organization, called The All India Trade Union Congress (AITUC) was established. Those who led this organization were also leaders of the national movement. It was the effort of NN Joshi that brought the Trade union law into operation from 1927, and the following year, the All India Trade Union Federation (AITUF) took birth.

Phase 3: 1947

The third phase began with India gaining Independence in 1947. The trade union movement was impacted by the Partition, especially in Bengal and Punjab. Within the next two years, four central trade union organizations came into operation in the country:

1. The All India Trade Union Congress,
2. The Indian National Trade Union Congress,
3. The Hindu Mazdoor Sangh, and
4. The United Trade Union Congress.

The working class movement gained a political face. The Indian National Trade Union Congress (INTUC) came to be the trade union arm of the Congress

Party. Similarly, the AITUC is the trade union arm of the Communist Party of India. Not only the workers, but also white-collar employees, supervisors and managers are organized by the trade unions, in the banking, insurance, petroleum and other sectors.

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Different Trade unions in India

The 430 million strong Indian workforce is growing two per cent each year. The three sectors that make up the Indian labor market are:

- Rural workers (constituting 60 per cent of the workforce)
- Organized sector (employing eight per cent of the workforce)
- Informal sector (which includes the growing software industry and other services, not included in the formal sector), which constitutes the rest 32 per cent of the workforce.

Currently, there are twelve Central Trade Union Organizations in India:

- All India Trade Union Congress (AITUC)
- Bharatiya Mazdoor Sangh (BMS)
- Centre of Indian Trade Unions (CITU)
- Hind Mazdoor Kisan Panchayat (HMKP)
- Hind Mazdoor Sabha (HMS)
- Indian Federation of Free Trade Unions (IFFTU)
- Indian National Trade Union Congress (INTUC)
- National Front of Indian Trade Unions (NFITU)
- National Labour Organization (NLO)
- Trade Unions Co-ordination Centre (TUCC)
- United Trade Union Congress (UTUC) and
- United Trade Union Congress – Lenin Sarani (UTUC – LS)

4.4 TRADE UNION CODE OF ETHICS

The code of discipline and conduct is meant to spread awareness among the workers about the expected conducted, demeanor and duties, or responsibilities. Each worker/employee is expected to behave and perform in a manner that will not affect the company values and commitments. The employees are expected to go about their work/business sincerely and honestly, with integrity. The employer is also expected to be an equal opportunity employer.

Certain factors determine the Code of Ethics for Trade Union policy of a company:

a. **Honesty and integrity:** Every organization expects its workers/employees work honestly and with complete integrity in a fair and transparent manner.

They are expected to be truthful in whatever they do as long as they are working in and for the organization.

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b. **Disclosure of information:** No worker/employees is allowed to reveal any information pertaining to the company to any external entity. But at the same time, employers should be transparent and reveal the various policies of the organization to their employees and inform them about the policies as well as the code of conduct.

c. **Harassment:** Any type of harassment, verbal or sexual is a strict NO at the workplace. Any form of physical harassment by any employee should be unacceptable.

d. **Concurrent employment:** Employees are expected to work only for their company and not for any other organization or entity outside of their workplace, unless their employer is aware of the same.

e. **Conflict of interest:** No employee should be indulging in any activity or profession that conflicts with the company's interests. Simply put, personal interests should not clash with company's interests.

f. **Confidentiality:** No confidential information pertaining to the company should leave the company through any employee. All financial records should be protected within the company along with the unpublished.

g. **Equal opportunity employer:** No organization should discriminate on the basis of caste, religion, race, color, gender, religion or physical disabilities.

h. **Misusing company resources:** Employees are expected to never abuse, mistreat or ill use the resources of the company. This includes, time, furniture, equipment, fixtures, intellectual property and other facilities. Employees should understand that use of company property is allowed to them only for business purposes. Therefore, it is up to them to use it in a cost-effective manner.

i. **Health and safety:** Each employee deserves to work in a safe, friendly, hygienic, clean, comfortable and well lit environment. To ensure that all these facilities are provided to the workers, a health and safety committee should be constituted by the company with representation from the workers' end too.

j. **Payment and gifts:** No employee should accept or donations, remuneration, gifts or payments that are illegal from any external organization or entity outside of the organization.

Check Your Progress

4. What are the three sectors that make up the Indian labour market?
5. What does IFFTU stand for?
6. What is the main objectives of code of discipline and conduct?

4.5 PRICE LEVELS

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A price level is the average of current prices across the entire spectrum of goods and services produced in the economy. In more general terms, price level refers to the price or cost of a good, service, or security in the economy. Price levels may be expressed in small ranges, such as ticks with securities prices or presented as a discrete value such as a dollar figure. In economics, price levels are a key indicator and are closely watched by economists. They play an important role in the purchasing power of consumers as well as the sale of goods and services. It also plays an important part in the supply-demand chain.

There are two meanings of the term price level in the world of business:

- The first is what most people are accustomed to hearing about the price of goods and services or the amount of money a consumer or other entity requires to purchase a good, service, or security in the economy. Prices rise as demand increases and drop when the demand decreases. This is used as a reference to check for deflation or the rise and fall of prices in the economy. If the prices of goods and services rise too quickly when an economy experiences inflation, a central bank can step in and tighten its monetary policy and raises interest rates. In turn, this decreases the amount of money in the system, thereby decreasing aggregate demand. If prices drop too quickly, the central bank can do the reverse and loosen its monetary policy, thereby increasing the economy's money supply and aggregate demand.
- The other meaning of price level refers to the price of assets traded on the market such as a stock or a bond, which is often referred to as support and resistance. As in the case of the definition of price in the economy, demand for the security increases when its price drops. This forms the support line. When the price increases, a sell-off occurs, cutting off demand. This is where the resistance zone lies.

Price level in economic world

In economics view, price level includes the buying power of money or inflation. In other words, economists describe the condition of the state of the economy by looking at how much people can buy with the same dollar of currency. The most common price level index is the consumer price index (CPI). The price level is analyzed through a basket of goods in which a collection of consumer based goods and services can be examined in aggregate. Changes in the aggregate price over time push the index making the aggregate of the basket of goods higher. Weighted aggregate are typically used rather than geometric means. Price levels provide a snapshot of prices at a given time, making it possible to review changes in the broad price level over time. As prices rise (inflation) or fall (deflation), consumer demand for goods is also affected. This leads to broad production measures such as Gross domestic product (GDP) higher or lower.

Price levels are one of the most viewed economic indicator in the world. Economists have widely believe that prices should stay relatively stable year to year so they do not cause undue inflation. If price levels rise too quickly, central bankers or governments look for ways to decrease the money supply or the average demand for goods and services.

Price level in investment world

Traders and investors make money by buying and selling securities. They buy and sell when the price reaches a certain level. These price levels are referred to as support and resistance. Traders use these areas of support and resistance to define entry and exit points. Support is a price level, where a downtrend is expected to pause due to a concentration of demand. As the price of a security drops, demand for the shares increases, forming the support line. Meanwhile, resistance zones arise due to a sell-off when prices increase.

Once an area or resistance is identified, it provides valuable potential trade entry or exit points. This is because as a price reaches a point of support or resistance, it will do one of two things, either bounce back away from the support or resistance level or violate the price level and continue in its direction until it hits the next support or resistance level.

4.6 COMPETITION FACTOR

In economics, competition is a condition, in which, different economic firms seek to obtain a share of a limited good by varying the elements of the marketing mix like price, product, promotion, and place. From a microeconomics perspective, competition can be influenced by five basic factors: product features, the number of sellers, barriers to entry, information availability, and location. These factors hinge on the availability or attractiveness of substitution. Product features essentially describe the level of differentiation. If a company's product is homogeneous that is, it is completely indistinguishable from products sold by competitors. This situation would imply heavy competition. Alternatively, a product might be completely differentiated, meaning that it can be totally unique. In this case, there might be few alternatives and thus low levels of competition. The level of differentiation is largely a subjective matter and subject to consumer opinion.

The number of sellers also impacts competition. If there are many sellers of an undifferentiated product, competition is considered to be high. If there are few sellers, competition is considered to be low. If there is a single seller, the market is considered to be a monopoly. Barrier to entry can influence the number of sellers. Market characteristics such as high capital investment requirements or heavy regulation may prevent new companies from entering the market, which in turn provides a level of protection to existing firms. With lower competition through barriers to entry, firms might be able to charge higher prices. Information availability is also important; it revolves chiefly around price discovery. When customers can

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efficiently and accurately find out prices across competitors, companies are less able to set prices and competition is more heated. An effective location strategy can corner a group of potential customers or otherwise reach them more effectively than the competition. For example, gas stations are often located on busy corners.

It's easy to understand these characteristics of competition through the lens of the two most extreme perfect competition and monopoly. In perfect competition, each firm has their marginal profit that is equal to the marginal cost. There is no economic profit. In a monopoly, the marginal profit is equal to the marginal revenue, which is the incremental revenue generated from selling one more unit of the product. Companies in perfect competition are considered to be price takers, meaning that they have no scope to set prices. This is the reason why marginal profit is equal to marginal cost. Perfectly competitive markets are defined by a homogeneous product, many sellers with low market share, and absolutely no barriers to entry or exit. These firms are unable to differentiate their products and their customers have highly accurate information.

A monopoly involves a single company dominating the entire market. In this situation, the firm sets the price, and competition is non-existent. Most markets are somewhere in between perfect competition and monopoly. For example, the market for soft drinks, dominated by Coca-Cola and Pepsi, could be considered an oligopoly where a few large firms dominate most of the market. The market for tomatoes could be considered a step or two above perfect competition; after all, some people are willing to pay more for organic or heirloom tomatoes, while others look only at the price.

4.6.1 Perfect Competition

Pure or perfect competition is a theoretical market structure, in which, the following criteria are met: all firms sell an identical product (the product is a 'commodity' or 'homogeneous'); all firms are price takers (they cannot influence the market price of their product); market share has no influence on price; buyers have complete or 'perfect' information–in the past, present, and future–about the product being sold and the prices charged by each firm; resources such as labor are perfectly mobile; and firms can enter or exit the market without cost. This can be contrasted with the more realistic imperfect competition, which exists whenever a market, hypothetical or real, violates the abstract tenets of neoclassical pure or perfect competition. Since all real markets exist outside the plane of the perfect competition model, each can be classified as imperfect. The contemporary theory of imperfect versus perfect competition stems from the Cambridge tradition of post-classical economic thought.

Perfect competition is a benchmark, or 'ideal type', to which real-life market structures can be compared. Perfect competition is theoretically the opposite of a monopoly, in which, only a single firm supplies a good or service and that firm can charge whatever it wants, since consumers have no alternatives and it is difficult for would-be competitors to enter the marketplace. Under perfect competition,

there are many buyers and sellers, and prices reflect supply and demand. Companies earn just enough profit to stay in business and no more. If they were to earn excess profits, other companies would enter the market and drive profits down.

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Perfect Competition is characterized by the following:

- All firms sell an identical product.
- All firms are price takers.
- All firms have a relatively small market share.
- Buyers know the nature of the product being sold and the prices charged by each firm.
- The industry is characterized by freedom of entry and exit (no barriers).

4.6.2 Imperfect Competition

Imperfect competition is a competitive market circumstances, in which, there are many sellers, but they are selling heterogeneous goods as opposed to the perfect competitive market scenario. Imperfect competition is the real world competition. Today, some of the industries and sellers follow it to earn surplus profits. In this market scenario, the seller enjoys the luxury of influencing the price in order to earn more profits. If a seller is selling a non-identical good in the market, then they can raise the prices and earn profits. High profits attract other sellers to enter the market and sellers, who are incurring losses, can very easily exit the market.

There are several types of imperfect competition as follows:

(a) **Monopoly Competition (only one seller):** It involves a firm with no competitors in its industry. A monopoly firm produces less output, has higher costs, and sells its output for a higher price than it would if constrained by competition. These negative outcomes usually generate government regulation.

(b) **Oligopoly Competition (few sellers of goods):** It involves an industry with only a few firms. If they collude, they form a cartel to reduce output and drive up profits the way a monopoly does.

(c) **Monopolistic Competition (many sellers with highly differentiated product):** It involves competition among many firms with slightly different products. Production costs are above what may be achieved by perfectly competitive firms, but society benefits from the product differentiation.

(d) **Monopsony Competition** (only one buyer of a product)**:** It involves a market with a single buyer and many sellers.

(e) **Duopoly Competition:** It involves a special form of oligopoly, with only two firms in an industry.

(f) **Oligopsony Competition:** It involves a market with a few buyers and many sellers.

Conditions that help cause imperfect competition are:

- Restricted flow of information on costs and prices,
- Near monopoly power of some suppliers,
- Collusion among sellers to keep prices high
- Discrimination by sellers against buyers on the basis of their buying power.

Characteristics of imperfect competition

The concept of imperfect competition was propounded in 1933 in England by Mrs. Joan Robinson and in America by E.H. Chamberlin. It is an important market category, in which, the individual firms exercise their control over the price to a smaller or larger degree. Professor Chamberlin called it a 'Monopolistic competition'. Under imperfect competition, there are large number of buyers and sellers. Each seller can follow its own price-output policy. Each producer produces the differentiated products, which are close substitutes of each other. Thus, the demand curve under monopolistic competition is highly elastic.

There are several characteristics of imperfect competition, which are as follows:

(a) **Large number of sellers and buyers:** There are large numbers of sellers in the market. All these firms are small sized. It means that each firm produces or sells such an insignificant portion of the total output or sale that it cannot influence the market price by its individual action. No firm can affect the sales of any other firm either by increasing or reducing its output, so there is no reaction from other firms. Every firm acts independently without bothering about the reactions of its rivals. There are a large number of buyers and none of them can affect price by their individual action.

(b) **Product differentiation:** Another important characteristic is product differentiation. The product of each seller may be similar to, but not identical to the product of other sellers in the industry. For example, a packet of Verka butter may be similar in kind to another packet of Vita butter, but because of the idea that there are differences, real or imaginary, in the quality of these two products, each buyer may have a definite preference for the one rather than for the other. As a result, each firm will have a group of buyers who prefer, for one reason or another, the product of that particular firm.

(c) **Selling costs:** Another important characteristic of the monopolistic competition is existence of selling costs. Since there is a product differentiation and products are close substitutes, selling costs are important to persuade buyers to change their preferences, so as to raise their demand for a given article. Under monopolistic competition, advertisement is not only persuasive, but also informatory because a large number of firms are operating in the market and buyer's knowledge about the market is not perfect.

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(d) Free entry and exit of firms: Firms under monopolistic competition are free to join and leave the industry at any time they like. The implication of this characteristic is that by entering freely into the market, the firms can produce close substitutes and increase the supply of commodity in the market. Similarly, the firm commands such a major amount of resources that in the event of losses, they can easily quit the market.

(e) Price-makers: In the monopolistic competitive market, each firm is a price-maker as it can determine the price of its own brand of the product.

(f) Blend of competition and monopoly: In this market, each firm has a monopoly power over its product as it would not lose all customers if it raises the price as its product is not perfect substitute of other brands. At the same time, there is an element of competition because the consumers treat the different firms' products as close substitutes. Hence, if a firm raises the price of its brand, it would lose some customers to other brands.

Check Your Progress

7. How can price levels be expressed?
8. What is support in the context of price demand?
9. Which factors can influence competition from a microeconomics perspective?
10. What are the conditions that help cause imperfect competition?
11. Why are selling costs an important characteristic of the monopolistic competition?

4.7 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The Trade Union Act 1926 defines a trade union as a 'combination, whether temporary or permanent, formed primarily for the purpose of regulating the relations between workmen and employers or between workmen and workmen, or between employers and employers, or for imposing restrictive condition on the conduct of any trade or business, and includes any federation of two or more trade unions.'
2. The assistance offered by a trade union to its member include:
   (a) Legal help: In addition to providing legal advice on employment issues, certain unions provide assistance in personal matters, such as housing, wills and debt.
   (b) Financial discounts: Union members have the chance to avail discounts on loans, mortgages, insurance, etc. from unions.

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3. When representatives of the trade union discuss matters that affect the workers, with the management of an organization, it is called negotiation.
4. The three sectors that make up the Indian labor market are:
   (a) Rural workers (constituting 60 per cent of the workforce)
   (b) Organized sector (employing eight per cent of the workforce)
   (c) Informal sector (which includes the growing software industry and other services, not included in the formal sector), which constitutes the rest 32 per cent of the workforce.
5. IFFTU stands for Indian Federation of Free Trade Unions.
6. The code of discipline and conduct means to spread awareness among the workers about the expected conducted, demeanor, and duties or responsibilities.
7. The price levels can be expressed in small ranges, such as ticks with securities prices or presented as a discrete value such as a dollar figure.
8. Support is a price level, where a downtrend is expected to pause due to a concentration of demand. As the price of a security drops, demand for the shares increases, forming the support line.
9. From a microeconomics perspective, competition can be influenced by five basic factors: product features, the number of sellers, barriers to entry, information availability, and location.
10. The conditions that help cause imperfect competition are:
    (a) Restricted flow of information on costs and prices,
    (b) Near monopoly power of some suppliers,
    (c) Collusion among sellers to keep prices high
    (d) Discrimination by sellers against buyers on the basis of their buying power.
11. Selling costs are an important characteristic of the monopolistic competition as there is a product differentiation and products are close substitutes. Selling costs are important to persuade buyers to change their preferences, so as to raise their demand for a given article.

4.8 SUMMARY

- A trade union is essentially an organization whose membership consists of workers and union leaders, who are united to protect and promote their common interests.
- It is clear to all that the very purpose of trade unions is to protect and promote the interests of their members. Their main aim is to ensure that

workers are not discriminated against and do not have to suffer injustice or unfair labor practices.

- Negotiating for better wages and allowances is the main function of a trade union. Using their collective bargaining power, trade unions also ensure better working conditions for workers.
- In India, the pace of development of trade unions was rather slow as compared to the West. The 430 million strong Indian workforce is growing two per cent each year. Currently, there are twelve Central Trade Union Organizations in India.
- The code of discipline and conduct is meant to spread awareness among the workers about the expected conducted, demeanor and duties or responsibilities. Each worker/employee is expected to behave and perform in a manner that will not affect the company values and commitments.
- A price level is the average of current prices across the entire spectrum of goods and services produced in the economy. In more general terms, price level refers to the price or cost of a good, service, or security in the economy.
- In economics, competition is a condition, in which, different economic firms seek to obtain a share of a limited good by varying the elements of the marketing mix like price, product, promotion, and place.
- Pure or perfect competition is a theoretical market structure, in which, the following criteria are met: all firms sell an identical product; all firms are price takers; market share has no influence on price; buyers have complete or 'perfect' information about the product being sold and the prices charged by each firm; resources such as labor are perfectly mobile; and firms can enter or exit the market without cost.
- Imperfect competition is a competitive market circumstances, in which, there are many sellers, but they are selling heterogeneous goods as opposed to the perfect competitive market scenario. Imperfect competition is the real world competition.

4.9 KEY WORDS

- **Collective bargaining:** It is the process through which representatives of management and the union meet to negotiate a labour agreement.
- **Code of Ethics:** It is the code of discipline and conduct, which communicates to the employees, the expected behaviour and the professional responsibilities.
- **Tick:** It is a measure of the minimum upward or downward movement in the price of a security or the change in the price of a security from trade to trade.
- **Oligopoly:** It is a market form wherein a market or industry is dominated by a small number of large sellers.

4.10 SELF ASSESSMENT QUESTIONS AND EXERCISES

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Short Answer Questions

1. What are the main characteristics of trade unions?
2. Write a short note on the phase one of trade unions in India.
3. What are the two meanings of the term price level in the world of business?
4. Write a short note on perfect competition.

Long Answer Questions

1. Describe the importance of trade unions.
2. Discuss the factors, which determine the code of ethics for Trade Union policy of a company.
3. Evaluate and differentiate between price level in economic world and investment world.
4. Explain the concept of competition factor.

4.11 FURTHER READINGS

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BLOCK - II
PROCESS OF PAY FIXATION

UNIT 5 PAY FIXATION PROCESS

NOTES

Structure

5.0 INTRODUCTION

Pay fixation is commonly used in case of promotion, but there are various other circumstances where pay fixation rules are applied. There are different provisions for pay fixation in cases of first appointment to the government service, appointment on deputation, re-appointment of a pensioner or fixation of pay after pay revision etc. Pay fixation under normal rules are held under Fundamental Rule 22, commonly referred to as FR 22. The unit introduces you to the pay fixation process and its components. You will also study about the basic idea of market survey and pay survey along with the purpose of conducting survey. This unit also explains the comprehensive process of designing the pay structure.

5.1 OBJECTIVES

After going through this unit, you will be able to:

- Understand the meaning of pay fixation process
- Learn the essentialities of surveying pay and compensation practices
- Discuss the concept of market survey and pay survey

5.2 SURVEYING PAY AND COMPENSATION PRACTICES

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Effort, responsibility, skill, experiences and working conditions have been used to differentiate the various rates of payment among the job groupings and surveys have been used to determine a specific rate of payment for a particular incumbent job holder.

Definition of Market Survey

The process of achieving the goal of the market has external payment equity within the organisation's ability to the pay limitation.

Definition of Pay Survey

A payment survey or a salary survey is typically conducted to gauge the organization's compensation levels with respect to the external environment. This clearly defines the specific pay for each job or individual service term. The pay scale of the organization is disposed, and the relative worth of the other jobs that are established with the respect to the identification of benchmark job.

Pay surveys are organised or conducted by a constructed written Questionnaire, telephonic surveys, newspapers, consultancy firms, payment.

A wage or salary survey is used to assemble the market pay data for superfluity of jobs on either a local or nationwide basis. This survey is usually performed in order to evaluate the fruitful or productive result of a company's current pay structure and their practices. Surveys are used to formulate for future perspectives or methods of compensation and they can be instrumental in revealing gaps and waste originating from current procedures and policies. An extensive survey of the compensation may also provide companies with salary data from other companies that will allow them to assess their own compensatory policies and modify them correspondingly. Survey data are used for compilation of various data and records from human resource departments. Information will be displayed on a wage or salary curve.

Purpose of the Survey

The main purpose of the survey is to determine the average compensation or payment paid to employees in one or more jobs. Compensation data is analysed to develop a comprehensive purpose of the amount of compensation paid that collected from several employers. Surveys may include one or more job titles, geographic regions and employer size. Pay surveys may be conducted by employer associations or group of employee, survey vendor and by individual employers. Survey data is time tactful and may become antiquated quickly. Surveys are identified by the year or quarter in which the data was accumulated. The purpose of pay surveys provide that comparison of salaries of the employees at the company.

Salary or Wage Surveys are analyses of compensation data. This data may comprises for determination of compensation such as follows:

1. Base salaries
2. Increase amounts of percentage
3. Merit Increases
4. Payment ranges
5. Bonuses
6. Allowances and Benefits

Salary Surveys may also comprises non-quantifiable aspects of compensation such as:

1. Required Educational Qualification
2. Geographical Location
3. Source of hire
4. Working Status

The surveys result are conducted by third parties such as associations, consultants, and survey vendors. Using third parties for results can be inexpensive compared to the cost of developing the same results yourself. Surveys have a large number of participants which may results in an accuracy analysis that conducted by associations and survey vendors.

- **Appropriate Jobs**

Salary Surveys collect the compensation data for one or more others jobs. The jobs may be depending upon industrial aspects and the size of employer. Some printing companies' survey may include titles such as Press Operator, Binding Machine Operator and Lithographic Press Operator. Job titles are also specific to the banking industry that includes specially Teller, Cashier, Account Manager and Investment Manager. Job titles should be unique titles that describe the job and nature of the work.

- **Summary**

Salary Surveyor surveying pay results should contain a summary of the data analysis of the job. This summary is useful for understanding the trends that are appearing the labour market and the employees.

- **Methodology**

The data of the survey should not be reported for very few incumbents. These are required to be reported the salary as well as averages. The 'mean' is the average of all numbers are divided by the amount of responses. The median is the central point or the midpoint with half of the responses are above that amount and half fall below. In salary data, the median tends to be lower than the mean due to that there is no upper limit of the rates that can be paid for a job. However, the lower limit is always be zero. Consequently, the distribution of salaries tends to be inclined with

a few salaries at the extreme high end of the range. In salary data, the median will always be lower than the mean.

- **Tabulations:**

Survey results must be tabulated at a minimum values by Job Title. This means that the median or average salary should be reported separately for each job in the survey by assuming that there were sufficient numbers of participants to make the meaningful analysis. If the survey comprises data from a large number of participants, the results of survey value will be increased, if the results can be tabulated by other employer demographics such as funding type either public or private, industry, geographic region, size or number of employees.

Participating in a Survey

The steps used to participate in a survey are as follows:

(a) Identify the response deadline

A salary survey will collect data during a stipulated time period so that the results will be published on time. If their responses are submitted late in that cases the survey vendor may not be accepted.

(b) Matching Jobs

The survey questionnaire to any institution job matching should be based on several factors as follows:

- **Title**- An identical job title is the easiest way to match the jobs on a survey questionnaire in any institution. All companies must have a President and at least one Secretary. Most of the companies have their Director of Marketing, Director of Information Systems, Director of Facilities, Director of Human Resources.
- **Organizational Structure**- The next simplistic technique for matching jobs are to find out the jobs in organizational structure that can easily match the implied or displayed structure on the survey. Although, a survey will examine the salary data of an individual for jobs at several levels within a career perspectives. There are few illustration that the jobs Accountant, Chief Financial Officer, Senior Accountant, Director of Accounting may be included in this survey questionnaire. The structural view of two or more jobs for an individual within our any institution may also closely match the structure of jobs on the questionnaire.
- **Job Duties-** The time consuming technique or methods and payment surveys is to match them on the basis of descriptions for matching jobs

Determining needs of data: Salary Ranges, lists of employees by job title with salaries.

Backup the Responses: Make a photocopy of the completed questionnaire before returning.

Compensation Practices

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There are top three compensation practices of the employees in the organisation are as follows:

- Establishing Market Informed Structure and Defined Compensation Philosophy.
- Well Communicated Compensation Plan or Structure.
- Recognition from Management

More organizations are adopting a formal, written compensation philosophy that ensures a compensation program supports the organization's culture.

> **Check Your Progress**
>
> 1. What are salary surveys and why are they conducted?
> 2. Name the top three compensation practices of the employees in the organization.

5.3 DESIGNING PAY STRUCTURE

Compensation decisions are based on three considerations.

- **Pay level**: Employees working on similar jobs in other organizations. Generally based on pay surveys. The objective of the pay level decision is to keep the organization competitive in the labour market.
- **Pay structure:** Employees working on different jobs within the organization. Generally based on job evaluation. The pay structure involves setting a value on each job within the organization relative to all other jobs.
- **Individual pay:** Employees working on the same job within the organization. The idea is to make pay attractive and satisfying to the individual employee.

5.3.1 Pay Level Decision

The pay level is decided by managers who compare the pay of people working inside the organization with those outside it. The pay level strategy is a major strategic choice that managers must make. Essentially, three pay level strategies i.e. high, low or comparable can be chosen.

High pay strategy: In this strategy, managers choose to pay higher than industry average levels. The assumption behind this strategy is that higher wages and salaries will attract and hold the best employees, and that this is the most effective long term policy. Organizations using this strategy are sometimes called *pacesetters or industry leaders.* The strategy may be influenced by pay criteria such as paying a living wage or paying on the basis of productivity.

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Low pay strategy: At the opposite extreme is the low pay strategy. In this case, the manager pays at the minimum level needed to hire enough employees. This strategy may be used because it may be all that the organization can pay. The ability to pay is restricted by internal or external factors such as a limited compensation budget or a forecasted decline in sales and profits.

Comparable pay strategy: It is referred to as *going wage* in the industry. This going wage is determined from pay surveys. The wage criteria are comparable wages, perhaps modified by cost of living or purchasing power adjustments. Thus, the policy of a manager following this strategy is to pay the current market rate in the community or industry an additional 5 per cent or so.

Choice of strategy: The choice of strategy partially reflects the motivation and attitudes held by the manager.

(i) An above average wage level is chosen, when,
  - Enterprise wants to counter competition in product market by hiring more competent personnel
  - Qualified persons are in short supply in relation to demand
  - Specialized skills are needed to implement technological change
  - Management finds unions overwhelming or to keep unions out of action
  - Higher productivity is linked to high wages
  - Enterprise wants to gain the image of progressive employer

(ii) Average rates may be decided, when
  - Product market is growing slowly
  - Supply of qualified persons is more than the demand
  - Enterprise wants to keep the reputation of stable employer with no layoffs

(iii) Below average rates may be selected, when
  - Product demand is falling
  - Unions are relatively weak or non-existent
  - Decisions of wage fixation authorities are not contrary to such rates
  - Rates are permitted by wage legislation

5.3.2 Pay Structure Decision

The next step is to construct an internal pay hierarchy or pay structure. The traditional way to develop the pay structure was to make a systematic comparison between the worth of one job and the worth of another, using job evaluation.

Determining Worth of Jobs

Job evaluation is a formal process by which the relative worth of various jobs in the organization is determined for pay purposes. Job evaluation relates the amount

of pay for each job to the extent to which that job contributes to organizational effectiveness.

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Job evaluation is usually performed by analysing job descriptions and, occasionally, job specifications. It is usually suggested that job descriptions be split into several series, such as managerial, professional, technical, clerical, and operative. It makes sense in written job descriptions to use words that are keyed to the job evaluation factors.

Typical of the factors most frequently used for job evaluation are education, experience, and amount of responsibility, job knowledge, work hazards and working conditions. Table 5.1 shows the popular job evaluation methods.

Table 5.1 *Job Evaluation Methods*

Comparison basis	**Non-quantitative comparison (job as whole)**	**Quantitative comparison (parts of factors of jobs)**	**Comparison of job evaluation systems**
• Paired comparison • Rating scales	• Job ranking • Job grading or classification	• Factor comparison • Point system	

Determining pay and job value relationship

The next step is assembling the job points obtained from the job evaluation data and the job rates fixed for the key jobs.

The management has to decide whether to pay the jobs on individual basis or on group basis. For purposes of administrative simplification, jobs would be grouped into wage classes or job grades. For example, positions with total points ranging from 200-300 might be placed in the same grade or classification with the same rate.

If some employees receive a higher pay than the pay fixed to their job grade maximum, they are considered overpaid. However, to gain acceptance of any wage and salary system one does not cut pay on any such jobs. What is often done is to red circle the jobs currently being paid more than the maximum for their new wage grades. This means that individuals holding such jobs would be paid the same as they have been as long as they keep the job. As changes take place red circle jobs will be reduced.

The number of grades must be chosen in such a way that it does not cause frustration to employees and administrative difficulties to the organization. However, fewer job grades may mean excessive pay roll costs.

Rate Range Decision

It is already pointed out that rate ranges or grade widths exist. However, in some industries it is typical for the trade unions to bargain for and achieve single rates for job grade. When managements welcome single rate structures it is for reasons of

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pay administrative convenience. However, to allow individual employee performance and useful experience to be rewarded managers decide in favour of rate ranges. There is no generally accepted criterion as to how wide ranges should be. The typical limits for relatively high skilled craft jobs are plus or minus 15 per cent around the medium trend line values but only plus or minus 5 per cent for relatively low-skilled jobs. Values of plus of minus 25 per cent around the median trend line values are commonly quoted for high-level executive jobs.

Researchers reported that most firms provide a spread of about 30 to 40 per cent. Specifically, it is recommended that wider ranges be established for managerial and professional personnel, since it takes them longer to become highly competent in their positions.

Grade Overlap Decision

A second rate range decision is how much, if any, overlap should exist among rate ranges. Most authorities recommend that some overlap is better than no overlap at all. The arguments may be summarized as follows:

- *Flexibility in rewarding*: It permits a greater pay spread, allowing greater flexibility in fitting rate to jobs, granting pay rates, and in transferring and promoting employees from one grade to another. There are often jobs that fall on or near the border line between grades. Individual employees doing these marginal jobs may be reasonably treated instead of adhering strictly to pay grade boundary values. Individuals with experience and merit need not be stagnated at a lower pay grade. They progress to higher pay grade without promotion.
- *Economy:* An overlapping structure of pay is less costly.
- *Competitive*: A non-overlapping structure is likely to result in a salary structure which will be out of line with the competitive salary market at a number of points.
- *Equitable:* A new inexperienced person by virtue of qualifications may be appointed in the higher grade and an experienced and competent performer may be in a lower grade. An overlap permits the experienced an opportunity to earn at a higher rate than the new, inexperienced employee in the next level grade. It may be argued that having one employee in a lower level job making more money than one in a higher paying one will create inequities. However, this is not always true because individuals at lower level jobs may be recognized as having certain compensation factors such as more seniority, experience or skill.

There are three methods of determining the degree of overlap, which is appropriate for given circumstances.

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1. *Set the midpoint of any job grades as the floor of the next higher grade*

This is a reasonable strategy since the mid point is essentially the basic rate and is the value that would be paid to the competent experienced employee if single rates instead of rate ranges were used. An employee paid below the midpoint of his job grade might be seen as a learner. If he is paid above the midpoint, it should be because he has shown above average job ability. So this method gives the high level performer in any job grade, a roughly equivalent rate to the learner, in the next higher job grade.

2. *Set an incremental step of lower grade as floor of next higher grade*

The method involves the establishment of incremental steps of pay within each grade. Let us assume that six steps are chosen to cover the rate range from minimum to maximum in each grade. The company might decide to set the floor of each grade, at say step 4 of the next lower grade. In a typical office job structure, the range for grade 3 jobs might spread from Rs 1,400 – 1,500 – 1,600-1,700-1,800-1, 900, in six steps. The floor of the next higher grade jobs, grade 4, would be set at step 4; Rs 1,700 and the rate range would be Rs 1,700-1,800-1,900-2,000-2,100-2,200. The floor for grade 5 would be Rs .2,000.

3. *Set a percentage differential between grade floors*

According to this method, a company may choose the same percentage differential between minimums of the grades or different percentage differentials. An example of same percentage differential; say 10 per cent is set between grade minima. If grade 3 minimum is ₹ 1,400, grade 4 minimum would be ₹ 1,540 and grade 5 minimum would be ₹ 1,694, (₹1,700 approximately).

5.3.3 Individual Pay Determination

Having determined the grades and rate ranges, management has to decide the pay for each individual. The question precisely is:

Whether all the individuals in jobs of the same level (rate range) should be paid the same.

There are broadly two distinct approaches.

1. Informal approach
2. Formal approach – (i) merit rating, and (ii) automatic progression

Some companies use a combination of the two formal methods.

The informal approach is characterized by the absence of well-established guides and controls. The lack of company-wide standards may result in pay decisions being influenced by favouritism or arbitrariness. Trade union pressures, biases and grievances become common. The approach is as such discouraged in a large organization. In a small outfit, it can be applied with great care.

The formal approaches can make use of either merit rating or automatic progression method or a combination of both. Employee merit rating is part of a formal systematic technique under which an employee's performance is assessed based on some set of measurements standards.

It is possible to develop a combined plan starting an employee on an automatic raise basis up to the range midpoint and then giving a raise based on merit. For example, in the range of ₹ 2,200-200-2,700-125-3,200 the merit rating will be utilized from ₹ 2,700 onwards. This midpoint salary may be the starting salary at the next higher grade level to justify the use of merit rating.

While merit rating is welcomed in principle, as it is linked to performance, there are many difficulties in its administration.

- Unions resist managements retaining the sole right to advance employee's pay.
- Differing opinions as to values and limitations of merit rating and consequent grievances.
- The human limitation in the rating process.

Automatic progression is relatively easy to administer. However, it lacks incentive and is inflexible.

Check Your Progress

3. What factors influence compensation decisions?
4. What do you understand by job evaluation?

5.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. A payment survey or a salary survey is typically conducted to gauge the organization's compensation levels with respect to the external environment. This clearly defines the specific pay for each job or individual service term. Pay surveys are organised or conducted by a constructed written Questionnaire, telephonic surveys, newspapers, consultancy firms, payment.
2. The top three compensation practices of the employees in the organisation are as follows:
   - Establishing market informed structure and defined compensation philosophy
   - Well communicated compensation plan or structure
   - Recognition from management

3. Compensation decisions are influenced by three considerations, namely:
   - Pay Level
   - Pay Structure
   - Individual pay

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4. Job evaluation is a formal process by which the relative worth of various jobs in the organization is determined for pay purposes. Job evaluation relates the amount of pay for each job to the extent to which that job contributes to organizational effectiveness.

5.5 SUMMARY

- Effort, responsibility, skill, experiences and working conditions have been used to differentiate the various rates of payment among the job groupings and surveys have been used to determine a specific rate of payment for a particular incumbent job holder.
- Market survey is the process of achieving the goal of the market. It has external payment equity within the organisation's ability to the pay limitation.
- A payment survey or a salary survey is typically conducted to gauge the organization's compensation levels with respect to the external environment. The pay scale of the organization is disposed, and the relative worth of the other jobs that are established with the respect to the identification of benchmark job.
- Pay surveys are organised or conducted by a constructed written Questionnaire, telephonic surveys, newspapers, consultancy firms, payment.
- A wage or salary survey is used to assemble the market pay data for superfluity of jobs on either a local or nationwide basis. This survey is usually performed in order to evaluate the fruitful or productive result of a company's current pay structure and their practices.
- Surveys are used to formulate for future perspectives or methods of compensation and they can be instrumental in revealing gaps and waste originating from current procedures and policies.
- The main purpose of the survey is to determine the average compensation or payment paid to employees in one or more jobs. Compensation data is analysed to develop a comprehensive purpose of the amount of compensation paid that collected from several employers.
- Surveys may include one or more job titles, geographic regions and employer size. Pay surveys may be conducted by employer associations or group of employee, survey vendor and by individual employers.
- The surveys result are conducted by third parties such as associations, consultants, and survey vendors.

NOTES

- Employees working on similar jobs in other organizations. Generally based on pay surveys. The objective of the pay level decision is to keep the organization competitive in the labour market.
- The pay level is decided by managers who compare the pay of people working inside the organization with those outside it. The pay level strategy is a major strategic choice that managers must make. Essentially, three pay level strategies i.e. high, low or comparable can be chosen.
- In high pay strategy, managers choose to pay higher than industry average levels. The assumption behind this strategy is that higher wages and salaries will attract and hold the best employees, and that this is the most effective long term policy.
- In low pay strategy, the manager pays at the minimum level needed to hire enough employees. This strategy may be used because it may be all that the organization can pay.
- Comparable pay strategy is referred as going wage in the industry. This going wage is determined from pay surveys. The wage criteria are comparable wages, perhaps modified by cost of living or purchasing power adjustments.
- Job evaluation is a formal process by which the relative worth of various jobs in the organization is determined for pay purposes. Job evaluation relates the amount of pay for each job to the extent to which that job contributes to organizational effectiveness.
- Job evaluation is usually performed by analysing job descriptions and, occasionally, job specifications. It is usually suggested that job descriptions be split into several series, such as managerial, professional, technical, clerical, and operative.
- Having determined the grades and rate ranges, management has to decide the pay for each individual. The informal approach is characterized by the absence of well-established guides and controls. The lack of company-wide standards may result in pay decisions being influenced by favouritism or arbitrariness. The formal approaches can make use of either merit rating or automatic progression method or a combination of both. Employee merit rating is part of a formal systematic technique under which an employee’s performance is assessed based on some set of measurements standards.

5.6 KEY WORDS

- **Pay survey:** It is also referred as a salary survey which is typically conducted to gauge the organization’s compensation levels with respect to the external environment.

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- **Pay level:** It refers to the fundamental unit in compensation structure of an organization, which is used to denote difference in compensation due to smallest possible change in job specification.
- **Job evaluation:** It refers to a systematic way of determining the value/ worth of a job in relation to other jobs in an organization.
- **Pay range overlap:** It refers to the level to which pay ranges in adjacent grades in a category overlap.

5.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answers Questions

1. What is the use of survey data?
2. How are survey results tabulated?
3. Briefly mention about the three factors that influence compensation decisions.

Long Answer Questions

1. Discuss the purpose of conducting survey?
2. What is the procedure for participating in a survey?

5.8 FURTHER READINGS

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UNIT 6 INCENTIVE SCHEMES

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Structure

6.0 INTRODUCTION

The term 'incentive' means a payment or concession given to the employees to stimulate them to increase their efficiency and productivity. The main purpose to provide incentive is to motivate the employees to work more and better in order to earn more and more amount as incentives. Managers use incentives as the most effective tool of motivation, incentives may be classified in two categories:

1. **Financial Incentives**: It is the amount that a company offers to its employees to encourage certain behaviours, actions and productivity such as attractive wages, high percentage of bonus, dearness allowance, travelling allowance, housing allowances, gratuity, pension, provident fund contributions etc.
2. **Non-financial Incentives**: These are the types of rewards that are not a part of an employee's pay such as designation, nature of the job, working conditions, status, privileges, job security, opportunity for advancement and participation in decision, making etc.

According to the surveys, non-financial incentives act as powerful motivators to the employees as compared to financial incentives. In this unit, you will study about monetary and non-monetary dimensions and will also learn the meaning, significance and types of incentive schemes. In addition to this, you will also study about the incentive schemes for direct and indirect workers.

6.1 OBJECTIVES

After going through this unit, you will be able to:

- Interpret the meaning of incentive
- Differentiate between monetary and non-monetary dimensions
- Discuss the incentives for direct and indirect categories

- Explain the meaning, significance and types of incentive schemes
- Describe the different types of incentive plans
- Examine the incentive schemes for direct and indirect workers

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6.2 MONETARY AND NON-MONETARY DIMENSIONS – INCENTIVE PLANS

There is huge difference in the policies and practices followed in incentive payment. Incentives are provided on different basis which can be classified into three groups: individual wage incentive plan, group incentive scheme, and organisation-wide incentive system.

The **individual wage incentive plan** is the extra compensation paid to an individual over a specified amount for his production effort. Individual incentive systems are based upon certain norms established by work measurement, techniques such as past performance, bargaining between union and the management, time study, standard data, predetermined elemental times and work sampling. There are four types of individual incentive systems such as measured day-work, piece-work standard, group plans and gains-sharing plans. Under the measured day-work incentive wage system, an individual receives his regular hourly rate of pay, irrespective of his performance. Piece-work system form the most, simple and frequently used incentive wage. In this, individual's earnings are direct and proportionate to their output. Group plans embody a guaranteed base rate to the workers in which the performance over standard is rewarded by a proportionate premium over base pay. Gains-sharing system involves a disproportionate increase in monetary rewards for increasing output beyond a predetermined standard. As the gains are shared with the entrepreneurs, the worker gets less than one per cent increment, in wage for every one percent increase in output.

The group or area incentive scheme provides a bonus for the payment either equally or proportionately to individuals within a group or area. The bonus is related to the output, achieved over an agreed standard or to the time saved on the job - the difference between allowed time and actual time. Such schemes may be most, appropriate where:

(a) people have to work together and teamwork has to be encouraged; and
(b) high levels of production depend a great deal on the cooperation existing among a team of workers as compared with the individual efforts of team members.

The organisation-wide incentive system involves cooperation among employees and the management and purports to accomplish broader organisational objectives such as:

(i) to reduce labour, material and supply costs;
(ii) to strengthen loyalty to the company;

(iii) to promote harmonious labour-management relations; and

(iv) to decrease turnover and absenteeism.

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One of the aspects of organisation-wide incentive system is profit sharing under which an employee receives a share of the profit fixed in advance under an agreement. The major objective of the profit sharing system is to strengthen the unity of interest and the spirit of cooperation. Some of the advantages of such a scheme are:

(i) it inculcates in employees' a sense of economic discipline as regards wage costs and productivity;

(ii) it engenders improved communication and increased sense of participation;

(iii) it is relatively simple and its cost of administration is low; and

(iv) it is non-inflationary, if properly devised.

One of the essentials of a sound profit sharing system is that it should not be treated as a substitute for adequate wages but provide something extra to the participants. Full support and cooperation of the union is to be obtained in implementing such a scheme. The remuneration that the employees receive for their contribution cannot be measured by the mere estimation of wages and salaries paid to them. Certain supplementary benefits and services known as 'fringe benefits' are also available to them. The characteristics of fringe benefits are:

1. These benefits are distinctly additional to the regular wages paid to the workers. As such, they are not provided as a substitute for wages or salaries of the employees.
2. These benefits are meant primarily to be of advantage to the employees.
3. The advantages accrued to the employees through the provision of fringe benefits are as such they cannot be secured through their own individual efforts.
4. Only those benefits fall within the purview of fringe benefits which are or can be expressed in cash terms.
5. The scope of fringe benefits is different from that of welfare services. Fringe benefits are provided by the employers alone whereas welfare services may be provided by other agencies as well. Benefits that have no relation to employment, should not be regarded as fringe benefits.

Fringe benefits have been classified in several ways. In terms of their objectives, Meggison classifies them into two groups: those providing for employees' security and those purporting to increase employees' job satisfaction causing reduction in labour turnover and improvement in productivity. The former group includes retirement programmes, workmen's compensation, unemployment compensation, social insurance, and other provisions. The latter group incorporates

vacations, sick leave, discounts on company goods and services, and allied tangible and intangible benefits.

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Fringe benefits are also categorised as statutory, contractual, and voluntary. Statutory benefits include social security and medical care, unemployment compensation, workmen's compensation, provident fund, and gratuity. The benefits provided by employers in pursuance of agreements with workers may include dearness allowance, house rent allowance, city compensatory allowance, medical allowance, night-shift allowance, heat, allowance, transport, housing and educational allowances. Voluntary fringe benefits which are provided unilaterally by the company include group insurance, death benevolent fund, washing allowance, leave encashment, leave travel concession, conveyance allowance, incentive for family planning, service awards, and suggestion awards.

Currently fringe benefits are a significant part of employee compensation system, and the employees tend to lake them for grasped and do not link these items with wages or income as they do not have any direct bearing on payments. They are no more on the fringe of compensation but form an integral component of individual earnings involving spiraling costs for the company. However, the fringe benefit system can become effective if attempts are made to gear them to the needs of human resource in organisational settings.

Check Your Progress

1. What does the term 'incentive' mean?
2. What are the types of individual wage incentive plan?
3. What is the main objective of the profit sharing system?
4. Give some examples of fringe benefits.

6.3 INCENTIVES FOR DIRECT AND INDIRECT CATEGORIES

Incentives schemes

An incentive scheme is a formal scheme that is usually utilised when a company can promote a certain kind of behaviour or action amongst to their customers. The key is that a specific time frame. The scheme endures for a fixed duration or stipulated time span only and then it is terminated by the company. This can be done for dealing with company workers as well as dealing with customers in order to increase the sales of the organisation. An interesting way of this concept is to simply pay a certain amount for the desired or outstanding result.

The **Incentive Schemes** are the programs which designed to encourage and motivate workmen or employee for higher efficiency and good output. The i**ncentives** are the monetary or financial rewards that can be given to the workmen

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or employees in recognition of their achievement of specific results during a stipulated time frame.

According to International Labour Organization (ILO), the incentives are **payment by results while** it is correct to says as the '**incentive system of payment'** since it highly focuses on motivation of the employee, that is incentives are imparted to the workers for their excellence performances of their organisation. Consequently, the employees are encouraged and motivated to earn the monetary amount more by increasing their productivity and well performance.

There are several incentive schemes where both the administrative and engineering staff is required to ensure a well organised production, quality and the measurement of work that can be successfully employed in an organisation or large firms. ILO has also classified the incentive schemes into **four major categories**. These are:

- **A scheme in which the worker's earning vary as output in the same proportion.** Under this category, the income of the worker may be proportionately with the level of output of their performance. This means, any gains and losses sustained as a result of worker's output shall be emanate to them. The two most popular incentive schemes are under this category as follows:
  (a) Straight piece work system
  (b) Standard hour system
- **A scheme in which the worker's earning can be vary less proportionately than the output.** Under this scheme, the employees will earn less in proportion to their level of output of their performance. There are four plans that comes in this category as follows:
  - o Halsey plan
  - o Rowan plan
  - o Barth variable sharing plan
  - o Bedaux plan

  The common feature of all these methods is that the specific time is used as a measurement of output and bonus or incentives is given for the time saved, a difference between the stipulated time set for the completion of any job and the time that actually taken from the employee for their outstanding performance. These incentive schemes are also known as **gain sharing schemes, whenever** both the employee and the employer share the gains resulting from the time saved.
- **A scheme in which worker's earning can proportionately more than output of their ability.** There are two methods under this category as follows:
  - o High piece rate system
  - o High standard hour system

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- **A Schemes in which the worker's earnings can differently at various levels of output of their performance.** This group includes several types of incentive schemes which explain that how the worker's earnings can be vary from minimum to maximum levels with respect to their various levels of output. It includes the following system:
  - o Taylor's differential piece rate system
  - o Merrick differential piece rate system
  - o Gantt task system
  - o Emerson efficiency plan

Therefore, these are some of the incentive programs that can be desirable to the employees to stay employed in a labour intensive industry, where the employees are the automated plants.

An incentive scheme can be interpreted as a formal or authorized plan that are designed to encourage specific behaviour or action by the target group during a specified span of time.

Types of Incentives Schemes

Basically there are 7 types of incentives schemes as follows:

(1) Employee Incentive Schemes: This **is** a certain kind of incentive scheme that is used for employees. The target here is to improve the performance of the employees of the company. Every company depends on its employees for its smooth functioning. Thus, incentives are provided to them. The main motive here is to make the employees feel a healthy sense of competition amongst themselves, reduce stress as well as make work fun. Also, the incentives may also be in a form of bonus, which might be a monetary reward or extra holidays. It totally depends on company to company regarding the incentive scheme they use.

(2) Consumer Incentive Schemes: The idea behind incentive schemes for customers is that it helps companies to rapidly increase their customer base. While the target clients can be lured with lucrative incentive schemes, the existing customers can also be retained. There is a sense of achievement that customers feel when they receive incentives such as a free product discount on their purchase if they buy more than one item, and so on and so forth.

(3) Points Program: The customers who usually shop in supermarket, departmental store or online, must be knowing about this scheme. Usually, the customer can either have a card or an account in which their points are added each time they shop from the particular location.

This means that with each purchase, a certain number of points are earned, depending on the number of items purchased and the total billing amount. Once enough points have been collected, you get a benefit such as a feed

product or a certain percent discount. This is somewhat similar to the reward points you earn when you book tickets with certain airlines and pay by card. Also, this encourages loyalty as well as sales because the masses believe that they will also be receiving benefits in the long run.

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(4) **Sales Incentive Schemes:** The motive behind these types of incentive schemes is to increase the sales of the company. That means, the number of person who had purchased the product will increase the number of sold units. Therefore, a Sales Incentive Plan (SIP) is needed. This can also be called as SIP in short in the world of business. This can divide the program of action into certain divisions such as targets for months, quarters or even years. In fact, each member of the sales teams is also motivated because of the benefits they receive if they are successful in their endeavours. This is one of the most direct incentive schemes that can exist. It is a clear relation between why the company extends such offers and what it expects from the customers in return.

(5) **Dealer Incentive Schemes:** Dealers are also very important in the chain of your product sale. This is because they are the ones who get you the products from the manufacturers. Thus, incentives are also great and actually very needed if you wish to keep them on their toes and active all the time. Thus, incentive schemes help every company to ensure their hold over the market position and their status, reduce the cost of sales and also make space for the launch of new items and services under their name.

(6) **Online Programs:** This may be a little tricky for you to understand if we go by the traditional definition of it. Thus, let's proceed with an example. Have you come across websites on the internet where you can earn incentives each time someone uses your referral code? They help the website grow as well as you get benefits. A chain reaction sort of thing is formed in this case where everyone in the chain benefits from one another.

(7) **Incentive Websites:** There are several websites which offer gifts or other exciting offers each time you are able to successfully complete the stated tasks or refer it to others. Usually, it is noted that these sites are sponsored by others in order to gain publicity and draw the masses. The reason why these sites are chosen is that they have a huge fan base and it is assumed that people will definitely avail of it. For example, Myntra is an online shopping site where you will often see certain top brands engaging in incentive schemes. This is because Myntra has successfully been able to establish a market in India and online buyers flock to their website for instant fashion trends.

Thus, there can also be monetary or financial and non-monetary or non-financial awards in the incentive schemes.

Monetary and Non-monetary Dimensions

The purpose of monetary incentives is to reward associates for excellent job performance through money, including profit sharing, project bonuses, stock options

and warrants, scheduled bonuses, and additional paid vacation time. Traditionally, these have helped maintain a positive motivational environment for associates. The monetary incentives

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are mostly given based on the performance of an employee. The monetary incentives given to the employee are direct benefits to the employee and is considered as an exposure to the employer.

The purpose of non-monetary incentives is to reward associates for excellent job performance through opportunities, including flexible work hours, training and education, pleasant work environment, and sabbaticals. The Non-Monetary rewards does not involve direct money. The employee does not get any money whereas he can also gets various benefits like Promotions, Food, Company uniforms, Flexible in time, Healthcare Benefits, Life insurance policy for family.

Difference between Monetary and Non-monetary Incentives

	Monetary Rewards	Non-monetary Rewards
Definitions	Monetary rewards are the incentives that involves directly money to the employees.	Though non-monetary rewards are also incentives that does not involve money to the employees directly.
Benefits	Monetary rewards are given to the employees as benefits from the organisation.	Non-Monetary rewards are usually given to all the employees of a certain level to offer them convenience and security.
Nature	The people of the organisation are received monetary benefits that concentrates on money by leaving the morality.	The people of the organisation are received non-monetary rewards that usually does not concentrates on money and also focus on the work activity of their services.
Observed as	It is an additional payment to the employees for that reason observed that monetary benefits are an expense to the organization.	Although it is an expense to the organization still there is no direct money that are received to the employee.
Contentions	Sometimes, one employee may arise disagreements in the other employee's monetary facility and also created unpleasant relationships within the employees in the organization.	Non-Monetary rewards does not arise any kind of disagreement or conflicts among the employees in the organisation.

Different types of incentive plans are:

1. **Profit Sharing**: It is available to full time employees. The organization provides funds/bonuses bases on a percentage of the amount of profit before tax. The employee receives a portion of this fund. For example, an employee receives a salary. This might be directed to a retirement program. Unfortunately, this method gives the poor performing employees an advantage.
2. **Project Bonus**: This is awarded to a team or an individual. The organization divides the reward among its team members according to the base salary of every employee. The organization might also reward a poor performing employee. This is a disadvantage for other employees as well as the team.
3. **Stock options**: This option is normally to the upper management. An organization might offer employee stock options to an executive employee

for retaining that particular executive. The employee has the option to purchase company stock at a fixed price without considering the current market price of that company.

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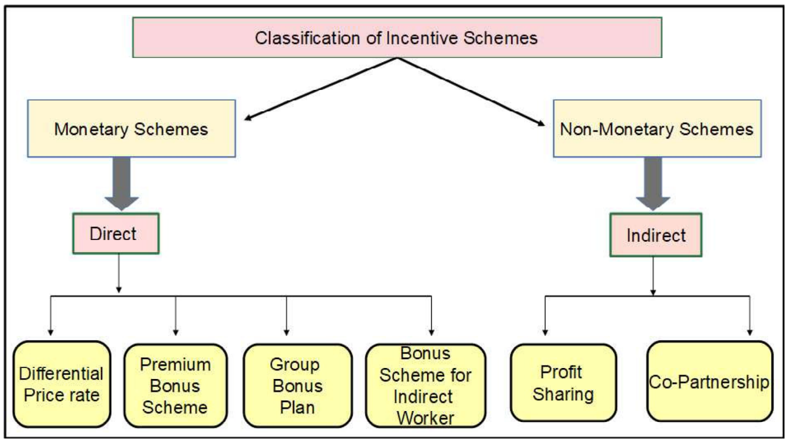
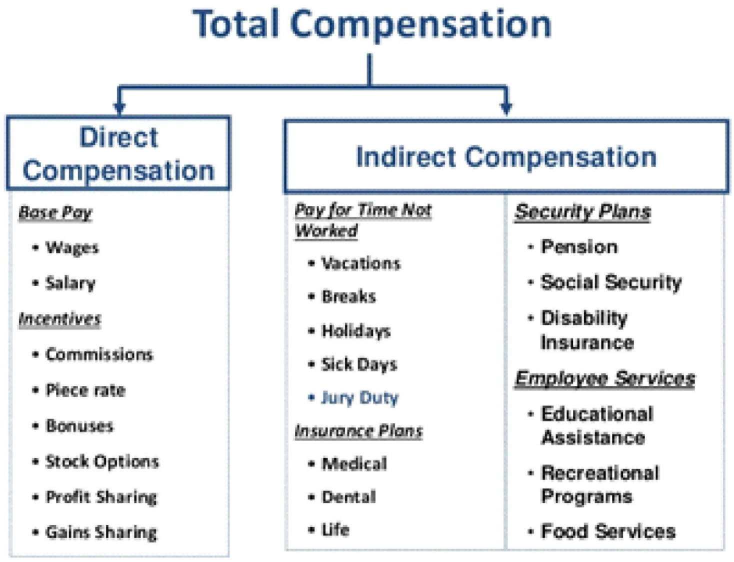
4. **Sales Commission**: When the company is not performing well, it is difficult to recruit sales employee who will be ready to work strictly on sales commission. To tackle this, the organization might offer base salary plus sales commission. The salesperson would definitely receive a base salary which will remain fixed and he/she will receive commission on every sale done.



Incentive schemes for Direct and Indirect Workers

Direct financial compensation is most widely known and recognized form of compensation. This type of compensation is highly sought after by workers, it is the money which is paid directly to employees in exchange for their labour. This includes everything from hourly wages, to set salaries, bonuses, tips and commissions.



Indirect financial compensation includes all amount to be paid out to an employee that are not included in direct compensation. This form of compensation is often understood as the portion of an employee's contract that covers items such as temporary leaves of absence, benefits and retirement plans.

Check Your Progress

5. What are incentive schemes and how are they useful?
6. Name the different types of incentive schemes.
7. What is project bonus incentive plan?
8. What does direct financial compensation mean?

6.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The term 'incentive' means a payment or concession given to the employees to stimulate them to increase their efficiency and productivity, the main purpose to provide incentive is to motivate the employees to work more and better in order to earn more and more amount as incentives.
2. There are four types of individual incentive systems such as measured day-work, piece-work standard, group plans and gain-sharing plans.
3. The main objective of the profit sharing system is to strengthen the unity of interest and the spirit of cooperation in the organization.
4. Some examples of fringe benefits include retirement programmes, workmen's compensation, unemployment compensation, social insurance, vacation pay, sick leave pay, discounts on company goods and services, and allied tangible and intangible benefits.
5. The **incentive schemes** are programs which are designed to encourage and motivate workmen or employee for higher efficiency and good output. The incentives are the monetary or financial rewards that can be given to the workmen or employees in recognition of their achievement of specific results during a stipulated time frame.
6. The different types of incentive schemes include the following:
   (a) Employee Incentive Scheme
   (b) Consumer Incentive Scheme
   (c) Sales Incentive Scheme
   (d) Points Program
   (e) Dealer Incentive Scheme

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(f) Online Programs

(g) Incentive Websites

7. Project bonus incentive plan is awarded to a team or an individual. The organization divides the reward among its team members according to the base salary of every employee. The organization might also reward a poor performing employee. This is a disadvantage for other employees as well as the team.
8. Direct financial compensation is most widely known and recognized form of compensation. This type of compensation is highly sought after by workers, it is the money which is paid directly to employees in exchange for their labour. This includes everything from hourly wages, to set salaries, bonuses, tips and commissions.

6.5 SUMMARY

- The term 'incentive' means a payment or concession given to the employees to stimulate them to increase their efficiency and productivity, the main purpose to provide incentive is to motivate the employees to work more and better in order to earn more and more amount as incentives.
- Financial Incentives is the amount that a company offers to its employees to encourage certain behaviours, actions and productivity such as attractive wages, high percentage of bonus, dearness allowance, travelling allowance, housing allowances, gratuity, pension, provident fund contributions etc.
- Non-financial Incentives are the types of rewards that are not a part of an employee's pay such as designation, nature of the job, working conditions, status, privileges, job security, opportunity for advancement and participation in decision, making etc.
- The **individual wage incentive plan** is the extra compensation paid to an individual over a specified amount for his production effort. Individual incentive systems are based upon certain norms established by work measurement, techniques such as past performance, bargaining between union and the management, time study, standard data, predetermined elemental times and work sampling.
- One of the essentials of a sound profit sharing system is that it should not be treated as a substitute for adequate wages but provide something extra to the participants.
- Fringe benefits are provided by employers in pursuance of agreements with workers may include dearness allowance, house rent allowance, city compensatory allowance, medical allowance, night-shift allowance, heat, allowance, transport, housing and educational allowances.

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- Voluntary fringe benefits which are provided unilaterally by the company include group insurance, death benevolent fund, washing allowance, leave encashment, leave travel concession, conveyance allowance, incentive for family planning, service awards, and suggestion awards.
- The **Incentive Schemes** are the programs which designed to encourage and motivate workmen or employee for higher efficiency and good output. The i**ncentives** are the monetary or financial rewards that can be given to the workmen or employees in recognition of their achievement of specific results during a stipulated time frame.
- There are seven types of incentives schemes such as employee incentive scheme, consumer incentive scheme, points program, sales incentive scheme, dealer incentive scheme, online program, and incentive websites.
- The purpose of monetary incentives is to reward associates for excellent job performance through money, including profit sharing, project bonuses, stock options and warrants, scheduled bonuses, and additional paid vacation time.
- The purpose of non-monetary incentives is to reward associates for excellent job performance through opportunities, including flexible work hours, training and education, pleasant work environment, and sabbaticals.
- Different types of incentive plans are profit sharing, project bonus, stock options, sales commission.
- **Direct financial compensation** is most widely known and recognized form of compensation. This type of compensation is highly sought after by workers, it is the money which is paid directly to employees in exchange for their labour.
- **Indirect financial compensation** includes all amount to be paid out to an employee that are not included in direct compensation.

6.6 KEY WORDS

- **Fringe benefit:** It refers to an extra benefit supplementing an employee's money wage or salary.
- **Financial incentives:** It refers to the money that a person, company, or organization offers to encourage certain behaviours or actions.
- **Non-financial incentives:** These refer to the types of rewards that are not a part of an employee's pay.
- **Incentive schemes:** It refers to the programs designed to encourage and motivate workmen for higher efficiency and greater output.

6.7 SELF ASSESSMENT QUESTIONS AND EXERCISES

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Short Answer Questions

1. What do you understand by financial and non-financial incentives?
2. List some characteristics of fringe benefits.
3. Write a short note on monetary and non-monetary dimensions.
4. Briefly mention about different types of incentive plans.
5. What are the different incentive schemes for direct and indirect workers?

Long Answer Questions

1. Discuss the four major categories of incentive schemes as classified by ILO.
2. Analyse the different types of incentive schemes.
3. Differentiate between monetary and non-monetary incentives.

6.8 FURTHER READINGS

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UNIT 7 WAGE DIFFERENTIALS

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Structure

7.0 INTRODUCTION

Broadly speaking, the word 'wage' refers to the compensation package received by the industrial or agricultural labourer for his services. Wages constitute the earnings of an industrial worker and, in the Indian context, may also include the earnings of the agricultural labourer. Compensation differentials are closely interlinked with wage system and their close association is widely recognized by academicians and industrial organizations. Wage differentials impact the economy as a whole, in terms of resource allocation, national income generation, economic and social welfare activity. Wage differentials are important to consider because they reflect the differences in the abilities of workers, differences in efficiency of industrial management and in consumer choices. Most importantly they affect the factor market in terms of labour mobility.

To emphasize the importance of wage differentials read a quote from Harry Ober's observations on wage differentials.

'Occupational differentials in wage rates are generally recognized as vital to the existing system of wages. Not only do they make possible compensation in accordance with skill, effort and working conditions, but they are necessary to ensure a sufficient supply of skilled and trained workers. To the worker in a particular occupation, wage differentials mean additional income for more arduous or more skilled performance. Differentials also indicate differences in craft or trade prestige.'

Noting the importance of wage differentials for the economy, the Committee on Fair Wages recommended that wage differentials should be established on the basis of certain considerations, which are as follows:

- The degree of skill
- The strain of work
- The experience involved
- The training required
- The responsibility undertaken
- The mental and physical requirements
- The disagreeableness of the task
- The hazard attendant on the work
- The fatigue involved

7.1 OBJECTIVES

After going through this unit, you will be able to:

- Understand the importance of wage differentials
- Discuss the meaning and purpose of executive compensation
- Analyse the principles of the Executive Compensation Policy
- Describe the components of remuneration individual/ group incentives
- Discuss the perquisites and principles of fringe benefits
- Analyse the meaning and types of profit sharing plans

7.2 INTRODUCTION TO IMPORTANCE OF WAGE DIFFERENTIALS

According to Robert E. Sibson, following factors contribute to the presence of wage diversity in a wage system:

(a) The difference in the earning capacity and earnings of the employers
(b) The personnel policy of the employer
(c) Factor (Labour) market imperfections
(d) Regularity of employment
(e) Job security
(f) The collective bargaining strength of the labour unions *vis-à-vis* the organization
(g) Individual employer's valuation of the labour
(h) The proportion of total costs represented by the labour costs
(i) Position of employer's product in the market
(j) Individual performance variations

(k) The percentage of fringe items in a worker's compensation

(l) Job disutility connected with the work and with specific jobs, and hazards inherent in the occupation and the links

Apart from the above mentioned factors, there are other broad factors also which contribute to the presence of wage differentials:

- Level of skill and the kind of training needed to perform an assigned job.
- Nature of job
- Physical and mental effort associated with performance of the job
- The disagreeableness of the assigned task
- Differences in efficiency levels of the workers
- Demand and supply of a specific kind of labour
- Existence of non-competing groups due to difficulties in the way of labour mobility from low paid to high paid employment
- Social prestige attached to the job
- Ignorance of prevailing wage rates
- Influence of customs and sociological factors
- Prevalence of different modes of payment
- Gender

The following factors determine the extent of wage differentials:

(i) Conditions prevailing the factor market

(ii) The extent of unionization

(iii) The collective bargaining capacity of the workers and the employers

(iv) The productivity growth rate

(v) The extent of regulations and the degree of centralization of decision making

(vi) Local customs and sociological factors

(vii) Economic condition of the country

(viii) The prevailing rate of wages

(ix) The capacity of an industry to pay

(x) The requirements of social justice

According to International Labour Organization (ILO), the importance of wage differentials are as follows:

1. They cause labour to be allocated among different occupations, industries and geographical areas in the economy in such a manner to maximize the national product.
2. They enable full employment of the resources of the economy to be attained.

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3. They facilitate the most desirable rate of economic progress.
4. By providing an important incentive for labour mobility, they bring about a re-allocation of the labour force under changing circumstances.
5. As scarcity differentials which may be due to specific skills and mental abilities produce wage differentials, they reflect the different degrees of scarcity of the different categories of labour.

7.3 INTRODUCTION TO EXECUTIVE COMPENSATION

The executive compensation is the pay related with indemnification to the executive for their service to the organisation. It can include the financial payment and non-financial recompenses to the executive for their service to the organisation. It combines the salary, bonus, stock, benefits to the government regulations, tax, the executive and rewards for performance. On account of the organisation, the executive compensation is the remittance that given to the higher management for their work. Corporate presidents, vice-presidents, chief executive officers, chief financial officers and also other senior executives are entitled to the executive compensation.

Purpose of the executive compensation

The executive compensation program has mainly three purposes, such as:

- It must entice executives with the skill, experiences, behavioural profiling that are essential to succeed in the performance.
- It must be ample to perpetuate these individuals in such manner for not leaving the alternative employment.
- It must incentivized them to perform in a manner consistent with the strategic and risk-management of the organisation and discourage self-interested behaviour.

Objectives

The major objectives of the executive compensation programs are as follows:

The manager should be motivated so that he/she can adopt strategies, investments, and actions that result in the increase of the shareholder values.

- The reimbursement package should be designed in such manner that it stimulates the executives for hard work, takes risks and take decisions especially in termination or retrenchment, pointed at increasing the shareholder's wealth.
- The executive compensation is designed with the intention for retaining the executives during the hard times caused due to the unfavourable market condition and industry factors of the organisation.

- The executive pays cost must be limited to the expanse where the shareholder's affluence does not affected.

Basically, the executive compensation packages are designed by the associated board of directors, the compensation committee, which is incorporated of the independent directors. The purpose of the committee which is created for paying incentives to their executive team that can be played a remarkable role in decision making and is responsible for the corporate strategic views and value formation of the company.

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Component or Principles of the Executive compensation Policy

Executive compensation is in variety of shape, size and variation depending upon business scope and opportunity of the organisation. Nevertheless, many of the basic structural component of executive compensation are more persistent, with disparity occurring in terms of strategy and implementation of the organisation. For example, several key types of pay based on the results of the EAA National Executive compensation Survey. Executive employees, such as chief executive officers (CEOs), chief financial officers (CFOs), company presidents, and other upper level managers are compensated differently than those at lower levels of an organization. Executive compensation consists of base salary, bonuses, long-term incentives, benefits, and perquisites. In addition to understanding the components of executive compensation, there are issues of equal payment and morality related with pay for these types of employees.

1. Base salary or pay

The most uncomplicated and acquaintance of executive compensation, most of the participants are determined for the base pay or salary using the price of the market, than any other employee's payment or salary. Annual pay adjustment for executives can be continued to run slightly higher than those percentages that offered to the other employee levels.

2. Short-term incentives

Short-term incentive is generally performance-based incentives that are given to the employees and designed to drive the business strategy and act as a key for achieving their goals. Metrics are commonly a combination of revenue, profit, operational, or customer service related goals, and also includes a component fix to individual performance goals of the organisation.

3. Long-term incentives

Long-term incentive rewards mean longer-term performance based goals that are entrenched on a two or three year rolling basis. Rewards can be made by cash to the employees and a great number of design features and alternatives can be allowed and customised to meet an organization's unique requirements.

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4. Benefits

Some benefits for executive level of the employees are simply increased and their different versions are offered to the non-executive workforce such as additional levels of life insurance, fully paid medical insurance, subsidiary pension plans, etc.

5. Perquisites (perks)

It can be a useful tool to attract and retain the key top talented executive. For example, it can include club memberships or a company vehicle. Although, these perks, are taken to the extreme can also be a cause of conflict internally if viewed as too spendthrift. Basically, these perks are most common only for the upper level executive job titles and are also mostly common in the private than the public sector where the factors such as shareholder and media inspection are less. The necessary benchmarks, executive pay can be effectively ascended to help ensure a strong future for any organization.

6. Executive Bonuses

In the executive base salary, a compensation that undulates most variable pay, according to their stage of performance. The use of compensation beyond base salary is purposive to motivate executives to reach brilliance performance goals of the organisation. For example, the specific profit levels and any reward them for their aim to reach these goals with supreme qualities. These type of variable payment is also known as executive bonus, which is a one-time payment binding to some short term performance goal of the employees. The bonus may be based on any number of performance output, ranging from judgments of executive performance by the board of directors, to levels of company profits or sharing market of the organisation. Now-a-days, all executives are received some sort of bonus as a part of their compensation package for their performance.

7. Equal Payment

Pay equity, or the fairness of pay, can be evaluated both internally and externally. These ideas are based on equity theory, a theory of motivation. Equity theory, briefly, indicates that a person examines what he/she brings to a job (inputs) and what he/she receives from a job (outcomes) and compares that to a reference person, evaluating the other person's inputs and outcomes. An employee might determine that he/she brings a certain level of education, experience, and effort to his/her job and that those inputs result in a certain level of salary and benefits. She would then compare this relationship to the education, experience, and effort, and the subsequent salary and benefits of another person. If these ratios are not equal, then the employee will feel treated unfairly. If this employee determines that her inputs are far greater than her counterpart's inputs, but their pay is the same, this employee will feel unfairly compensated. External equity is the assessment of the fairness of pay in similar jobs in different organizations. Executives who compare their pay to executives in other similar firms are making an assessment of external equity. External equity can be determined through market pay surveys, in which companies share information about the pay and benefits in their jobs. Additionally,

the pay levels of executives may be public knowledge, either in company publications to shareholders or in trade organizations. If an executive is compensated highly as compared to others in similar companies, he or she is likely to feel positively about this situation; however, executives who are compensated at a lower rate than comparable executives in other companies may attempt to have their salary raised or may look for another position. Internal equity is an assessment of the fairness of pay in different jobs within the same organization. Executives and employees compare their inputs and their pay to one another so as to determine if they are fairly treated. Internal equity is often referred to as pay structure, and there are two types of pay structures: egalitarian and hierarchical. In egalitarian pay structures, the range of pay from the lowest paid employee to the highest paid employee is not very big; there are not large differences in pay. Egalitarian structures tend to be preferred by the lower-paid employees, because they feel that executive pay is not too high. However, executives may become dissatisfied in organizations with egalitarian pay structures, because they feel that their pay may not be commensurate with their skills or job duties. Hierarchical pay structures, conversely, have a fairly wide range of pay between the lowest and highest paid employees. In hierarchical pay structures, upper-level employees are likely to be paid very high salaries, which they are likely to find satisfying. However, in hierarchical structures, employees in low-level jobs may feel unfairly treated because of their relatively lower pay rate. Many critics argue that executive pay is far too high, and that these pay rates invite ethical problems. To examine the fairness of executive pay, several factors must be assessed. First, the executive pay package should be responsible to shareholders, which means that it is not so high that it detracts from company profits or that its incentives discourage unethical influence of stock prices. Second, pay packages must be competitive with those of other similar organizations so that executives can be recruited, rewarded, and retained successfully. If a pay package is not competitive, there may be motivation problems or turnover. Third, executive pay should fit with the company's strategy so that it encourages overall company success. This is particularly relevant in regards to short-term bonuses and long-term incentives which can be used to steer the performance of the executive and the organization. Finally, compensation for executives must be in compliance with regulations. There are a number of laws regarding retirement plans, stock options, and other compensation components which must be followed when designing executive pay plans.

8. Insurance

Insurance is a means of protection from financial loss. It is a form of risk management, primarily used to safeguard against the risk of a contingent or uncertain loss. An entity which provides insurance is known as an insurer, insurance company, insurance carrier. A person or entity who buys insurance is known as an insured or as a policyholder. The insurance transaction involves the insured assuming a guaranteed and known relatively small loss in the form of payment to the insurer in exchange for the insurer's promise to compensate the insured in the event of a covered loss.

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Check Your Progress

1. What do you understand by wage differentials?
2. What is executive compensation and what does it involve?

7.4 COMPONENTS OF REMUNERATION INDIVIDUAL/GROUP INCENTIVES

An employee is entitled to get several benefits like financial and non-financial in their services of the organisation. Component of remuneration individual of the employee are wages and salary, incentives, benefits, perquisites, and non-monetary benefits.

(a) Wages and salary

Wages represent hourly rates of pay, and salary refers to the monthly rate of pay, irrespective of the number of hours put in by an employee. Wages and salaries are subject to annual increments. They differ from employee to employee, and depend upon the nature of job, seniority, and merit.

(b) Incentives

Incentives are paid in addition to wages and salaries. Incentives depend upon productivity, sales, profit, or cost reduction efforts. There are:

(1) individual incentive schemes

(2) group incentive programmes.

Individual incentives are applicable to specific employee performance. Where a given task demands group effort for completion, incentives are paid to the group as a whole. The amount is later divided among group members on an equitable basis.

(c) Benefits

These include such employee benefits as provident fund, gratuity, medical care, hospitalisation, accident relief, health and group insurance, canteen, uniform, recreation and many like these.

(d) Perquisites

These are allowed to executives and include company car, club membership, paid holidays, furnished house, stock option schemes and the like- Perquisites are offered to retain competent executives.

(e) Non-monetary Benefits

These include challenging job responsibilities, recognition of merit, growth prospects, competent supervision, comfortable working conditions, job sharing, and flexitime.

Types of Group Incentives Plans

Companies use three major types of group incentives plans are as follows:

Team Based or Small Group Incentive Plans: A small group of employees shares a financial reward when a specific objective is met. Team based is similar to individual incentives with one exception. Each group member receives a financial reward for the attainment of group goal.

There are three types of teams in an organization.

1. Work teams
2. Project teams
3. Parallel teams

1. **Work teams:** Work teams refer to organizational units that perform the work of the organization on an ongoing basis. Membership is relatively permanent, and members work full time in the team. Customer service teams and assembly teams on production lines represent excellent example of work teams.
2. **Project Team:** Project teams consist of a group of people assigned to complete a one-time project. Members usually have well-defined roles and may work on specific phase of project, either full time or in addition to other work responsibility of teams. Project teams usually work across such functions as engineering, product development and marketing to ensure that the final product meets company specification in the term of cost.
3. **Parallel Teams:** Parallel teams includes employees for assign to work on a specific task further more to normal work duties. The moderator parallel indicates that an employee works on the team task while continue to their work on normal duty. Parallel teams are also operate on temporary basis until it works climax in a recommendation to top management level of the organisation.

Teams or groups may ultimately receive incentive pay based on such criteria as customer's satisfaction (i.e. customer service quality), Safety records, quality and production records. Although these criteria apply to other categories to incentive programs as well (individual, company wide, and group plans) companies allocate awards to each worker based on the group's attainment of predetermined performance standards.

7.5 FRINGE BENEFITS/PERQUISITES

Fringe benefits are the additional benefits and services that can be provided by a company to its employees in addition to their direct salary. Therefore, fringe benefits can be defined as the additional benefits and services that a company provides to its employees on the basis of their performance. Both the terms, benefits and

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services, are considered similar by most people but some believe that they are entirely different. According to them, benefits are applicable only for those items that can be associated with some monetary value whereas services is applicable for the items that cannot be associated with any direct money values. However, more or less, both the terms, benefits and services, mean the same in reference to fringe benefits.

The fringe benefits help:

1. Lessen fatigue
2. Oppose labour unrest
3. Satisfy employee objectives
4. Promote recruitment
5. Minimise turnover
6. Reduce overtime costs

Principles of Fringe Benefits

There are few factors that must be considered while determining the fringe benefits, which must be provided to the employees of a company. These are:

1. Benefits and services must be provided to the employees of a company to provide them better protection and encourage their well being. The top management should not feel as if it is doing some charity by giving incentives to their employees.
2. The benefits that are provided to the employees should fulfil the real life requirements of the employees.

Table 7.1 *Examples of Monetary Benefits*

Benefits	***Example***
Legally required payments	Old age, survivors and health insurance Worker's compensation Unemployment compensation
Dependent and long term benefits	Pension plan Group life insurance Group Health insurance Prepaid legal plans Sick leave Dental benefits Maternity leave
Payments for time not worked	Vacations Holidays Voting pay allowance
Other benefits	Travel allowance Company car and subsidies Child care facilities Employee meal allowances Moving expense

3. The benefits and services should be cost effective.
4. Fringe benefits should be monitored with proper planning.
5. While determining the fringe benefits, the requirements of employees that are communicated by union representatives must be considered.
6. The employees of a company should be well informed so that they can make better utilisation of fringe benefits.

Types of Fringe Benefits

As we have discussed in the concept, fringe benefits can be of two types. One that can be measured in terms of money value and the other that cannot be measured in terms of money value. Fringe benefits such as medical insurance and holiday pay that can be associated with money value, are known as monetary benefits whereas benefits such as company newspaper and company service that cannot be associated with any money value, are known as non-monetary benefits.

Table 7.2 *Examples of Non-monetary Benefits*

Benefits	***Example***
Treats	Free lunch Coffee breaks Picnics Birthday treats Dinner for the family
Knick-Knacks	Company watches Desk accessories Wallets T-shirts Diaries and planner

Important Fringe Benefits

Some important fringe benefits are:

- Payment for the time employees have not worked
- Insurance benefits
- Compensation benefits
- Pension plans

Let us now study them briefly here:

Payment for the time employees have not worked: This fringe benefit forms an important benefit for the employees of company. Mostly every company provides the payment for time not worked benefit to its employees. Payment for time not worked benefit can be of two types, on-the-job free time payment and off-the-job free time payment. On-the-job free time includes lunch periods, coffee breaks, rest periods, get-ready times and wash-up times whereas off-the-job free time includes vacations, sick leave, public holidays and casual leave.

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Insurance Benefits: Insurance benefits are also an important fringe benefit for the employees of a company. Nowadays, every company provides its employees with the facility of purchasing insurance policies at a price, which is much less than the cost the employees would have to pay if they were to buy insurance themselves.

Compensation Benefits: Companies also provide compensation benefits to its workers against some disability or injuries to the employees or their family members. Other employees of the company contribute to the funds that are collected for the ill or injured employees. All these compensation benefits form a part of the Workmen's Compensation Act.

Pension Plans: Companies also provide supplementary income or pension to its employees after their retirement. These pension plans can be company paid or both company and employee paid. In addition to the pensions, companies also provide bonus to the employees reaching superannuation.

7.6 PROFIT SHARING

A profit sharing plan is a formal arrangement under which employers make additional payments to the base pay of some or all employees, usually on an annual basis. Profit sharing plans are based on a formula that links the size of the total bonus pool to an accounting measure of periodic (typically annual) profit, such as net profit (total income less operating profit) or net profit after tax.' The term 'profit sharing' is self-explanatory in the sense that these plans are applicable only to profit making organizations thereby excluding the public sector organizations and non-profit entities. Payments under this plan could be made either in the form of cash or in the form of restricted company shares. Although generally the profit sharing schemes cover all the employees, in some organizations, the cover of these schemes is limited to only select groups such as executives or managerial cadre.

Organizations introduce profit sharing schemes in pursuit of the following objectives:

- For making employees more committed towards the organizational growth and progress
- For stimulating employee participation in company affairs
- For promoting better cooperation between management and employees
- For recognizing the right of the employees, that is the right to share profits to which they are morally entitled
- For sending a goodwill message to the employees

7.6.1 Types of Profit Sharing

The three types of profit sharing plans are as follows:

1. **Current distribution plans:** Under this plan, the company distributes a proportion of its profits directly to its employees on a regular basis. This

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disbursement could be made annually or half yearly, but some companies prefer to make quarterly disbursements. The payments could be in cash or shares. However, from the motivational point of view, companies prefer to make the payments in cash. The per centage of the amount paid by the company is dependent on the yearly profits generated by the company.

2. **Deferred payment plans:** Under this plan, each employee's share of profit is held by the company in trust for distribution at a later date. Companies which use deferred plans usually pay the amount held in trust when the employee retires or leaves the company. In other words, deferred plans act as a kind of retirement saving plan for the employee. The payments can again be made either in cash or in the form of restricted shares. The advantages of deferred plans are, firstly, it is immune to market fluctuations because of the long term equalization effect. Secondly, it offers substantial tax advantage. By placing a reward premium on a long and loyal service, companies try to encourage long term commitment from its employees.
3. **Combination plans:** As the word implies, 'combination' plan consists of making part payments in form of current payments and a part later as deferred payments. Combination plans are used by companies for providing cash incentives and a long term retirement saving plan to the employees.

Michael Armstrong classifies the main types of profit sharing plans in a slightly different manner. His classification is as follows:

(a) **Cash:** plans in which a proportion of the profit is paid in cash directly to the employee.

(b) **Stock:** plans in which a proportion of the profit is distributed in the form of company shares.

7.6.2 Advantages and Disadvantages of Profit Sharing

The advantages associated with profit sharing plans are as follows:

- By sharing the profits with the employees, the organization seeks to send a message of 'sharing the success'
- Profit plans can be used for stimulating the performance among employees. The awareness that organizational growth leads to incentives can motivate individuals to perform.
- Removes the feeling of 'us and them' and encourages a team spirit among the employees and the employer
- Acts as a retirement saving plan, especially the deferred payment plan

The disadvantages of profit sharing are as follows:

- In profit sharing plans, the line of sight between individual performance and the reward is weak and blurred. The reason being that rewards are dependent

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on profits and they in turn are influenced by variables which are not under the control of employees. For instance, the employees have little control over the product pricing strategy, product development or the prevailing conditions of the market. In other words, unlike performance or output methods, employees have minimal control over outcomes that determine rewards. According to Shields, in profit plans 'the perceived link between effort and reward is lost and hence, so is any positive motivational potential.'

- Profit sharing plans tends to encourage 'free riding' or 'social loafing' among employees especially in plans which make equal payments irrespective of individual contributions. Free riding occurs when employees derive benefits of group membership without making any proportionate contribution to it. In an organizational set up where rewards are based on the combined output of a group, there may be individuals who exert very little effort knowing that their efforts will be combined with others for computing incentives. This tendency of loose efforts is known as social loafing.
- Shields points out that in situations where the eligible workforce size is larger, the line of sight between the effort and reward becomes weaker. He further explains that 'the greater the number of co-workers the less likely the individual will be to believe that their effort level will have any impact on company performance and the less likely that they will therefore be contribute to further task effort.' By this observation, Shields tries to indicate that profit sharing plans are less suitable for large organizations.
- Linking rewards to profits is fraught with the risk of causing reward dissatisfaction especially in times of low profitability.
- Profit sharing plans necessitate sharing of financial information with the employees, which usually most managements are unlikely to do. Therefore, profit sharing plans are more suitable for organizations which follow the principles of 'open' book management.
- More than often profit sharing plans are opposed by labour unions because they perceive it as an attempt to substitute variable for fixed base pay by the management. In the presence of profit sharing plans, the unions find it difficult to maintain standard pay rates for the same jobs across different organizations.

Check Your Progress

3. What is the difference between wage and salary?
4. How does individual incentive scheme differ from group incentive scheme?
5. Define fringe benefits.
6. Name the three types of profit sharing plans.

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7.7 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Wage differentials reflect the differences in the abilities of workers, differences in efficiency of industrial management and in consumer choices. Most importantly they affect the factor market in terms of labour mobility.
2. The executive compensation is the pay related with indemnification to the executive for their service to the organisation. It can include the financial payment and non-financial recompenses to the executive for their service to the organisation. It combines the base salary, bonus, stock, long-term incentives, benefits to the government regulations, tax, the executive and rewards for performance.
3. Wages represent hourly rates of pay, and salary refers to the monthly rate of pay, irrespective of the number of hours put in by an employee. Wages and salaries are subject to annual increments. They differ from employee to employee, and depend upon the nature of job, seniority, and merit.
4. Individual incentives are applicable to specific employee performance. Whereas when a given task demands group effort for completion, group incentives are paid to the group as a whole. The amount is later divided among group members on an equitable basis.
5. Fringe benefits can be defined as the additional benefits and services that a company provides to its employees on the basis of their performance.
6. The three types of profit sharing plans are current distribution plans, deferred payment plans, combination plans.

7.8 SUMMARY

- Wage differentials are important to consider because they reflect the differences in the abilities of workers, differences in efficiency of industrial management and in consumer choices. Most importantly they affect the factor market in terms of labour mobility.
- The executive compensation packages are designed by the associated board of directors, the compensation committee, which is incorporated of the independent directors.
- Executive compensation consists of base salary, bonuses, long-term incentives, benefits, and perquisites. In addition to understanding the components of executive compensation, there are issues of equal payment and morality related with pay for these types of employees.

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- The most uncomplicated and acquaintance of executive compensation, most of the participants are determined for the base pay or salary using the price of the market, than any other employee's payment or salary.
- Short-term incentive is generally performance-based incentives that are given to the employees and designed to drive the business strategy and act as a key for achieving their goals.
- Long-term incentive rewards mean longer-term performance based goals that are entrenched on a two or three year rolling basis.
- Perquisites or perks are most common only for the upper level executive job titles and are also mostly common in the private than the public sector where the factors such as shareholder and media inspection are less.
- Equity theory, briefly, indicates that a person examines what he/she brings to a job (inputs) and what he/she receives from a job (outcomes) and compares that to a reference person, evaluating the other person's inputs and outcomes.
- External equity is the assessment of the fairness of pay in similar jobs in different organizations. Executives who compare their pay to executives in other similar firms are making an assessment of external equity.
- In hierarchical pay structures, upper-level employees are likely to be paid very high salaries. However, the employees in low-level jobs in may feel unfairly treated because of their relatively lower pay rate.
- An employee is entitled to get several benefits like financial and non-financial in their services of the organisation. Component of remuneration individual of the employee are wages and salary, incentives, benefits, perquisites, and non-monetary benefits.
- Wages represent hourly rates of pay, and salary refers to the monthly rate of pay, irrespective of the number of hours put in by an employee. Wages and salaries are subject to annual increments.
- Incentives are paid in addition to wages and salaries. Incentives depend upon productivity, sales, profit, or cost reduction efforts.
- Perquisites are allowed to executives and include company car, club membership, paid holidays, furnished house, stock option schemes and the like- Perquisites are offered to retain competent executives.
- Non-monetary benefits include challenging job responsibilities, recognition of merit, growth prospects, competent supervision, comfortable working conditions, job sharing, and flexitime.
- A small group of employees shares a financial reward when a specific objective is met. Team based incentive plan is similar to individual incentives with one exception. Each group member receives a financial reward for the attainment of group goal.

- Work teams refer to organizational units that perform the work of the organization on an ongoing basis.
- Project teams consist of a group of people assigned to complete a one-time project. Members usually have well-defined roles and may work on specific phase of project, either full time or in addition to other work responsibility of teams.
- Parallel teams includes employees for assign to work on a specific task further more to normal work duties. Parallel teams are also operate on temporary basis until it works climax in a recommendation to top management level of the organisation.
- Fringe benefits are the additional benefits and services that can be provided by a company to its employees in addition to their direct salary. Therefore, fringe benefits can be defined as the additional benefits and services that a company provides to its employees on the basis of their performance.
- Fringe benefits can be of two types. One that can be measured in terms of money value and the other that cannot be measured in terms of money value. Fringe benefits such as medical insurance and holiday pay that can be associated with money value, are known as monetary benefits whereas benefits such as company newspaper and company service that cannot be associated with any money value, are known as non-monetary benefits.
- Some important fringe benefits are payment for the time employees have not worked, insurance benefits, compensation benefits, pension plans.
- A profit sharing plan is a formal arrangement under which employers make additional payments to the base pay of some or all employees, usually on an annual basis. Profit sharing plans are based on a formula that links the size of the total bonus pool to an accounting measure of periodic (typically annual) profit, such as net profit (total income less operating profit) or net profit after tax.'
- The three types of profit sharing plans are current distribution plans, deferred payment plans, and combination plans.
- Profit sharing plans tends to encourage 'free riding' or 'social loafing' among employees especially in plans which make equal payments irrespective of individual contributions.

7.9 KEY WORDS

- **Wage differentials:** It refers to the difference in wages between workers with different skills in the same industry or between those with comparable skills in different industries or localities.
- **External equity**: It refers to the situation in which employees of a company receive pay that is fair, when it is compared to the pay of employees in other companies who do the same job.

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- **Profit sharing:** It refers to the various incentive plans introduced by businesses that provide direct or indirect payments to employees that depend on company's profitability in addition to employees' regular salary and bonuses.
- **Short-term incentives:** These are intended to compensate executives for achieving the company's short-term business strategy based on achievement of goals by the board compensation committee.

7.10 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Type Questions

1. List the considerations recommended by the Committee on Fair Wages.
2. What are the factors that determine the extent of wage differentials?
3. Briefly mention about perquisites and non-monetary benefits.
4. Write a short note on important fringe benefits.
5. What is the meaning and objectives of profit sharing?

Long Type Questions

1. Discuss the importance of wage differentials.
2. Describe the types of group incentive plans.
3. What are the principles and uses of fringe benefits?
4. Examine the advantages and disadvantages of profit sharing.

7.8 FURTHER READINGS

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UNIT 8 INTRODUCTION TO JOB EVALUATION

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Structure

8.0 INTRODUCTION

Job evaluation is a process of determining the relative worth of a job. It is a process, which is helpful even for framing compensation plans by the personnel manager. Job evaluation is concerned with assessing the value of one job in relation to another. It is only when each job has been properly evaluated that a sound wage structure can be built. Job evaluation is the output provided by job analysis. It uses the information in job analysis to evaluate each job for a suitable compensation. It is a formal and systematic comparison of jobs in order to determine the worth of one job relative to another. In this unit, you will learn about job evaluation and the various methods, aims, features, principles and steps involved in a job evaluation programme. You will also learn about the importance of a computer-aided job evaluation and its utility in an organization along with internal equity, external equity and pay surveys.

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8.1 OBJECTIVES

After going through this unit, you will be able to:

- Understand the nature and objectives of job evaluation
- Describe the principles and procedure of job evaluation programme
- Discuss the employee stock option plan and non-monetary incentive schemes

8.2 NATURE AND OBJECTIVES

Numerous definitions of job evaluation have been provided by different scholars and authorities. In the following section you shall be provided with some definitions of job evaluation, which are considered to be useful for understanding the term. According to Michael Armstrong, 'Job evaluation is a systematic process for defining the relative worth or size of jobs within an organization in order to establish internal relativities and provide the basis for designing an equitable grade and pay structure, grading jobs in the structure and managing job and pay relativities.' According to ILOs Job Evaluation: Studies and Reports, job evaluation is 'an attempt to determine and compare demands which the normal performance of a particular job makes on normal workers without taking into account the individual abilities or performance of the workers concerned.' According to Glossary of Currently used Wage terms compiled by US Department of Labour, 'Job evaluation is the evaluation or rating of jobs to determine their position in the job hierarchy. The evaluation may be achieved through the assignment of systematic points or the use of some other systematic method for essential job requirements, such as skills, experience and responsibility.' From the above definitions of job evaluation, following features of a job evaluation can be defined:

- It is a systematically planned procedure or a process
- It helps in establishing pay differentials
- It defines the worth and size of the job
- It determines the position of the job in the job hierarchy
- It serves as the basis for establishing an equitable grade and pay structure

  Job evaluation can be of two types:

  (a) **Analytical job evaluation:** Analytical job evaluation process involves determination of value or size of the job, and this value is determined on the basis of number of elements of factors present in the job. This process is useful for designing an appropriate grading method, which in turn is useful for making pay decisions. The most commonly used approach for analytical job evaluation is the point-factor scheme.

  (b) **Non-analytical job evaluation:** Non analytical job evaluation process compares the whole job, for the purpose of placing them in a grade or

a rank order. In this process the factors or elements are not analyzed. Job ranking is a method used for non-analytical job evaluation.

8.2.1 Features of Job Evaluation

In the following lines, the features of analytical job evaluation shall be outlined because it pertains more to the reward management perspective.

I. **Systematic:** As a process, job evaluation is considered to be systematic because it is based on factual evidence on the nature of the jobs. The factual evidence is provided by the process of job description which summarizes the elements of the job. It is on the basis of factors or elements that job evaluation determines the value or size of the job.

II. **Judgmental:** When you say judgmental, you do not mean that the process of job evaluation is not objective, in fact you are just trying to point at the human element involved in the job evaluation process. As said it has been mentioned above that job evaluation is based on facts, but these facts have to be interpreted and it is during interpretation that human subjectivity comes into play. At times the factual information does not provide any clue about the level at which demands are present in a job. In situations like this, human judgment is the only solution available. Therefore, job evaluations are objective but a certain degree of human judgment is also essential for the process.

III. **Concerned with evaluating only jobs:**This feature is related to the primary function of job evaluation, i.e., to evaluate jobs and not the individuals. The focus of the job evaluation process is the content of the job in terms of the demands it makes on the job holder. The performance of the job by the job holder is neither within the purview of the job evaluation process nor within its scope.

IV. **Concerned with internal relativities:** Analytical job evaluation is an effective tool for an organization to assess the relative size of jobs within the organization.

8.2.2 Aims of Job Evaluation

According to ILO report, 'The aim of majority of systems of job evaluation is to establish, on an agreed logical basis, the relative values of different jobs in a given plant or machinery, i.e., it aims at determining the relative worth of a job.' The report identified the following aims for a job evaluation process:

- Determining and maintaining complete, precise, objective and specific description of each job or occupation in the entire organization.
- Establishing and maintaining standard procedure for the determination of relative worth of specific job or occupation in the organization.
- Determining fair and equitable rate of pay or salary or wage (as the case may be) for each specific job or occupation.

- Establishing a pay scale which is equitable *vis-à-vis* other jobs in the organization, and industry.
- Ensuring that similar wages are paid to similarly qualified employees for similar work.
- Determining and establishing fair and precise criteria's for considering employee's promotion and advancement.
- Providing a factual basis for determining wage rates of similar jobs in an industry or in a community.
- Providing relevant information for facilitating employee selection, placement, training and other similarly related issues.
- According to Michael Armstrong, job evaluation aims to:
    - i. Determine and establish the relative value or size of the jobs.
    - ii. Generate relevant information necessary for designing and maintaining an equitable pay structure
    - iii. Provide an objective basis for grading of jobs
    - iv. Enable external (market) comparison with jobs having similar complexity and size
    - v. Ensure that organizations meet legal regulations like Equal Remuneration Act, etc.

The above mentioned aims make it amply clear the importance of job evaluation programmes for an organization.

Check Your Progress

1. What is job evaluation according to Milkovich and Newman?
2. What is non-analytical job evaluation process?

8.3 INTRODUCTION TO PRINCIPLES AND PROCEDURE

For putting the job evaluation programme into practice, certain principles have to be considered or taken into account. These broad principles, according to A. L. Kress, are as follows:

- While conducting job evaluation, the job has to be rated and not the individual.
- Each element associated with the job should be rated on the basis of what the job itself requires.
- The elements selected for rating should be unambiguously defined and thoughtfully selected.

- The elements chosen for rating should be explained in clear, precise and in understandable terms.
- The job rating plan must be simple yet comprehensive so as to enable the foreman and the employees to understand the job rating plan.
- Foreman should be made part of the job rating plan and must be encouraged to participate in the ratings of jobs in their own departments.
- Cooperation of the employees must be ensured for the success of job rating and this cooperation can be promoted by allowing the employees an opportunity to discuss the ratings among themselves.
- While explaining and discussing the rating plan with employees and foreman, care should be taken to avoid discussion of money value. Only point values and degrees of each element should be discussed.

8.3.1 Procedure of Job Evaluation Programs

Following are the steps involved in a job evaluation programme:

I. **Analyse and prepare job description:** The first step in job evaluation is the preparation of job description to summarize the most important elements of the job. In fact job description is the basis for conducting an effective job evaluation. Job descriptions are inclusive of nature of job, responsibilities associated with the job and characteristics associated for effective job performance.

II. **Select and prepare a job evaluation plan:** This step involves breaking down of jobs into its component parts. The process involves identification of factors and elements which form the necessary prerequisite for job performance, and determination of their value. It is during this stage that written instructions for evaluation are prepared.

III. **Classify jobs:** During this stage the jobs are grouped and arranged in appropriate sequence in terms of value to the organization and relating them in monetary terms to determine the job's relative value.

IV. **Install the programme:** This is the most crucial step in terms of implementation of job evaluation plan, because this stage involves presentation and explanation of plan to the employees. For successful conduct of job evaluation, it is necessary to ensure employee participation and acceptance of job evaluation plan.

V. **Maintain the programme:** The job evaluation scheme is not over with the generation of evaluation reports, in fact the organization continues with the process because new jobs are added to the old ones thereby needing evaluation.

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8.4 INTRODUCTION TO BASIC JOB EVALUATION METHODS

The principal focus of job evaluation process is to determine the relative worth of the jobs within an organization. A systematic comparison of existing jobs in an organization helps in establishing a job hierarchy which ranks jobs in terms of their relative contribution to the organizational objectives. Achievement of organizational objectives rests more on the efficient performance of the CEO than on its Regional Manager. But the question is how to measure the value of jobs of the CEO and the Regional Manager. There is no objective method available for measuring the value of job in relation to organizational objectives. Therefore, organizational rewards are usually based 'on important components generally agreed to make one job worth more than another.' These 'important components' are called compensable factors and this consists of skills, education and ability; the degree of responsibility attached with the job and the working conditions. Determining the relative worth of jobs is very important from the reward perspective of an organization, therefore most organizations use some form of job evaluation method to evaluate jobs. The methods of job evaluation are:

- Job Ranking
- Job Classification
- Point Method

8.4.1 Job Ranking

Job ranking is the simplest and the most primitive way to evaluate jobs and this method is perfectly suitable for small enterprises. This method compares the whole jobs with one another and hierarchically arranges them according to their size and value to the organization. This method is called ranking because it ranks the job on the basis of their importance to the organization. Job ranking method compares the jobs, but for comparison, it does not use any explicit set of compensable factors or elements. There are two methods for job ranking, namely:

- Alternation ranking method
- Paired comparison method

In alternation ranking method, job descriptions are alternately arranged at each extreme by the evaluators. In this method, the evaluators start by ranking the most valued and the least valued job in the organization, for example 10 for the most valued and 1 for the least valued. This is followed by the next most valued and the least valued, i.e., 9 and 2. In this way the evaluators rank all the jobs of the organization.

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Paired comparison method (see Table 8.1) is a sophisticated method of ranking which relies on statistical techniques. This method compares each job separately with every other job in the organization. Points are allotted on the basis of comparison and the jobs are ranked on the basis of total points. For instance, if a job is more valuable than the one to which it is compared, the job is allotted 2 points on the scale; if the job is equally important to the job to which it is compared the job is allotted 1 point on the scale; if it less important, then the job is given 0 points on the scale. The allotted points are finally added and on the basis of the total points the jobs are ranked.

Table 8.1 *Pair Comparison Method*

Job Reference	A	B	C	D	E	F	Total Score	Ranking
A	2	-	2	2	2	2	8	2
B	1	0	-	1	0	1	3	4
C	-	0	1	0	1	0	2	5=
D	2	2	2	2	2	0	10	1
E	2	0	1	-	2	0	5	3
F	1	-	-	1	0	-	2	5=

(**Source:** *Michael Armstrong: Reward Management)*

Job ranking is a simple method to use but in practice it has some disadvantages. The method just simply ranks the job and while doing this it fails to provide any sort of information on the distances between the jobs, therefore making it difficult to assign salary levels. The evaluators may agree on the differences in value of the job, but the ranking does not provide any indication about the magnitude of the difference in value. Another practical difficulty is associated with defining the criteria on which the job is ranked. More than often, the criteria's are so badly defined, that the whole process of evaluation becomes an exercise in human judgment and subjectivity. Further, the evaluator using this method must be knowledgeable about every single job in the organization, which limits the possibility of the methods application to small organizations.

8.4.2 Job Classification

Job classification (Table 8.2) is a non-quantitative technique of job evaluation which the whole job is analysed with a pre-determined standard. In this approach, a series of classes cover an entire range of jobs which exist in an organization. The compiled job descriptions are compared with the existing class descriptions to determine the class to which the job can be fitted in or assigned to. Each class description is generally enough to facilitate the appropriate 'fitting-in' of the job description. The class description can be made more descriptive by including the benchmark jobs which belong to each class.

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Table 8.2 Job Classification Used by an Engineering Firm

Engineer 1	Engineer 2	Engineer 3	Engineer 4
Assists in development, testing, and documentation of software programmes. Undertakes design and analysis tasks as a project team member. Basic minimum requirements are a Bachelor's degree or the equivalent and up to one-two years of experience.	Develops project plans, functional specifications, and schedules. Designs and performs analysis on complex programs and systems. Assists in determining product needs and enhancements. Basic minimum requirements are a bachelor's degree in engineering, computer science or related technical field and four to six years of experience or a Master's degree and two to four years of experience.	Acts as project engineer for complex programs in design, development and analysis. Proposes new ideas and products and guides their implementation. Provides technical direction in area of specialty on major products. Typical minimum requirements are a bachelor's degree in engineering, computer science, or a related technical field and six or more years of experience or a Master's degree and four to six years of experience.	Provides technical direction and advice to management in long range planning for areas of technological research. Designs, researches, and develops new systems while providing guidance to support staff. Typical minimum requirements are a bachelor's degree in engineering, computer science, or a related technical field and ten years of experience or a master's degree and six years or more of experience.

Job classification (Table 8.3) offers some advantage. It is fairly simple for organizations to group jobs and it is equally simple for the employees to understand and accept the classification. The main strength of job classification is its flexible nature, which makes it applicable to large number and wide variety of jobs. Job classification method allows for easy assimilation of new jobs into an already existing hierarchy of classes.

Table 8.3 Comparison of Job Evaluation Methods

	Advantages	Disadvantages
Ranking method	Simple, easy to explain and easy to understand.	Application of the method becomes difficult with the increase of jobs. Criteria for comparison are not clearly defined.
Classification method	Can integrate a large number of jobs into one system.	Descriptions often involve human judgment, thereby losing its element of objectivity.
Point method	Clearly defined criteria in form of compensable factors are used.	Has a tendency to become rule or procedure bound.

On the flip side, job classification method suffers from certain limitations. Writing class descriptions can be very challenging because being precise in defining

a class will surely help in making the evaluation more reliable, but at the same time, it will also limit the number of jobs which can be classified. Therefore writing class descriptions can be a tight rope walk. The method is also criticized for using subjective judgments for slotting jobs into classes for instance in situations where a job falls between two classes, human judgments are used for resolving such issues. In practice, job classification depends too much on job titles and this dependency makes the method overlook the specifics of job content.

8.4.3 Point Method

The point method is a quantitative approach to job evaluation which involves breaking down of jobs into components or key elements. After breaking down the job into elements, the elements are compared against specially developed numerical scales. Each job is allocated points on the numerical scale on the basis of presence of factors or elements in the job. The points allocated to factors are totaled to determine the job size and the job's relative value. According to Milkovich & Newman, the common characteristics of the point method are:

- Identification of compensable factors
- Numerical scaling of factors
- Determination of the relative job on the basis of scaling of factors

Point method is most prevalent of all the job evaluation approaches and unlike ranking and classification methods, the points method relies on explicit criteria, which is compensable factors, for determining the size and value of the job. The methodology used in the point approach to job evaluation is as follows:

I. **Selection of factors:** On the basis of organizational needs, the aims of job evaluation and the types of jobs to be covered, the factors or components of the job are selected and defined. These factors represent the demands made by the jobs in terms of interpersonal skills, physical efforts, mental demands, emotional demands, problem solving, decision making, knowledge, and competency etc. These factors represent either the whole of the job or the key components associated with the job. It is the level at which these factors apply to the job which determines the relative values and size of the job.

II. **Factor plan design:** After the factors have been identified and defined by the job evaluators, the next step is to define levels for each factor. Factor plan design consists of dividing the factors in levels and assigning factors to respective levels. It is the extent of responsibility inherent in a factor that might be present in the job which determines the number of levels present in a factor plan design. The levels in each factor are defined in order to guide the evaluator in determining the extent to which the factor applies in a job. Points are allocated to each factor by the evaluator. The total score of the factor is then divided between the levels to produce the factor scale.

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III. **Job or role analysis:** The first step towards job evaluation in point method is the analysis of jobs or roles with respect to the presence of each factor. The objective of this analysis is to provide factual basis for the evaluator for selecting the level at which the factor is present in the job.

IV. **Evaluating jobs:** In an organization jobs are usually evaluated by a panel consisting of HR department personnel, line manager and the union representatives. The panel first studies the job analysis and then reaches a consensus on the level and the score that should be given to each factor. Subsequently the scores are totalled to estimate the relative size and value of the job vis-à-vis the organizational objectives.

From reward management perspective, there is no direct relationship between points scored in job evaluation and the pay packet. However, the utility of job evaluation lies in the ranking order of jobs which forms the basis for dividing the jobs into grades. Compensation or remuneration or pay range is fixed for each grade after considering the external equities.

Check Your Progress

3. List the two methods of job ranking.
4. What is the methodology used by point approach in job evaluation?
5. Why is writing class descriptions challenging?

8.5 EMPLOYEE STOCK OPTION PLAN

Over the past two decades, employee incentive pay schemes have assumed a greater importance as a component of compensation package. According to Towers Perrin survey, despite the existence of various forms of equity based incentive schemes like share incentive plans, cash based profit sharing, employee stock purchase plans, etc., most or rather an overwhelming number firms in the US used incentive pay schemes which rely on stock options. Earlier stock options were basically a standard feature of executive compensation package in the American and European companies, but in the recent past, stock option schemes have been extended by companies to include other employees as well. According to Hall and Liebman, the growing popularity and acceptance of stock options by companies can be explained by the argument that 'stock options help align the incentives of executives with the interests of shareholders and help start-up firms by substituting for salary in order to reduce cash outflows.' Smith and Watts, on the other hand, identified tax reasons for the growing popularity of stock options. According to them, 'stock options are advantageous from a tax perspective, in that they enable the firm to compensate executives or employees in a way that is more advantageous from a tax standpoint than paying a cash salary.'

8.5.1 Meaning of Stock Option Plans

According to Organization for Economic Co-operation and Development (OECD), 'a stock option is a financial instrument that represents the right to buy a certain asset at a designated price (exercise price) during a predetermined period, at any time within the predetermined period for American style options or at the end of the predetermined period for the European style options.'

In simple words, stock options are incentive schemes which provide an employee with the right to purchase company stock at stipulated price over a specific period of time. In case the value of the stock appreciates, the employee is entitled to buy the stock at a price that is lower than its market value. The four stages involved in a stock option scheme are as follows:

- The granting of stock to the employee
- Vesting (minimum holding period specified for the stock)
- The exercise of option
- The sale of the shares acquired through the exercise of options

Stock options are incentive schemes under which employees of the company are granted stocks in the company as a compensation for work. The stock options are usually not tradable and the employee is not permitted to dispose the stock in any other way. The tax system of some countries allow tax benefits for stock option schemes, thereby making it one of the preferred ways of compensating employees as compared to ordinary stock options. For illustrating stock option schemes, the following stock option scheme introduced by PepsiCo has been provided.

In 1989, PepsiCo introduced a stock option scheme to providing its employees with an ownership stake in the company. Till 1989, PepsiCo used the stock option scheme exclusively to reward senior executives, but in 1989 it developed a stock option plan known as 'Share Power Plan' which offered stock options to all the company's roughly one hundred thousand full-time employees. As part of the scheme, on July 1st of each year, the company granted stock options worth 10 per cent of their previous year's compensation including bonuses and overtime to its employees. The options gave the employees the right to purchase the PepsiCo stock at July 1 price at any time during the next 10 years. The employees can exercise each annual grant at the rate of 20 per cent per year. As an example, employees who made 20,000 dollars last year would be granted 2,000 dollars in options this year, exercisable over the next 10 years. They could exercise up to 20 per cent, or 400 dollars in the first year. If the offering price was 20 dollars per share and one year later the stock price had risen to 25 dollar per share, the employee could purchase 10 shares, which at the offering price of 20 dollars per share would cost 200 dollars and would now be worth 250 dollars.

8.5.2 Types of Stock Option Plans

Basically, there are two types of stock option plans:

- Non-Qualified stock option plan
- Incentive stock option plan.

The operational mechanics of both the plans are similar but each has its own unique distinctive features.

I. **Non-qualified Stock Option Plan:** These plans are the most prevalent and popular type of plan used by most of the companies to reward their executives. Organizations prefer using non-qualified plan because of the flexibility it offers in terms of design and administration. This type of plan is not bound by the statute or government regulations regarding the minimum price requirements, maximum grant periods or maximum exercise and holding periods. Its unfettered nature allows the companies to customize the stock option plans to go well with their individual objectives. For example, some companies may want to limit the effectiveness of the option after death or disability, while others would like to extend the term of the option to the duration of an employee's career etc. actually, in a non-qualified stock option plan, the duration of the option, the exercise period and the participation in the plan are t flexible. Furthermore, this plan allows the company flexibility in terms of pricing of options, which can be set either below or above the current market value. From the taxation point of view, the employee incurs no tax liability at the time of the grant, but he or she incurs tax liability while exercising the option. When the option is exercised, the excess of the stock market's value over the option price is taxed as ordinary income. In addition, any subsequent appreciation that is realized when the acquired stock is sold is liable to be taxed as capital gains by the tax authorities. In a non-qualified stock option plan, the employer receives a business expense deduction in the amount when the employee realizes his/her ordinary income.

II. **Incentive Stock Options:** These plans are designed as a 'tax favoured way' to deliver stock to the employees. In its operational aspects, the incentive stock option plans are quite similar to non-qualified stock option plans. However, unlike the latter, in incentive stock option plans, the employee and the plan are subject to several restrictive statutes and tax regulations. Adhering to tax regulations under the incentive stock option plan offers twin benefits to the employees, which are; firstly, they escape the tax net both during the grant and at the time of exercising the option, and secondly, the gains made on the sale of acquired shares is treated as capital in nature rather than as ordinary income. Companies prefer incentive stock option plans because of favourable long term capital gain tax treatment and the deferral of taxation till the date the acquired shares are sold. Nevertheless, the difference between the option price and the market price is subject to alternative minimum tax.

8.5.3 Advantages and Disadvantages of Stock Option Plans

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The popular reasons for favouring stock option plans are as follows:

- Stock option plans can be used effectively for creating a sense of involvement among employees.
- These plans can be used as effective catalyst for increasing the employee productivity.
- Growing companies can use it an effective instrument for attracting and retaining personnel.
- In times of capital and liquidity crunch, stock option plans can be used by companies for remunerating employees without paying cash.
- When compared to other incentive schemes, stock options are relatively inexpensive for companies to implement and maintain.

Limitations of stock option plans

- Only profit making companies can effectively use this incentive tool.
- Falling stock prices can become a matter of concern for employees.
- In practice, huge stock options have led to companies' techniques of incentivizing as a questionable managerial decision.
- Administrative costs can become sizable with the growth in the number of participants.

Despite its limitations, stock option plans continue to find favour among companies as a tool for 'integrating the concept of ownership and empowerment into the fabric of entire management process.' (PepsiCo). In general, one can distinguish between the performance-related pay schemes at the individual, group and organization-wide levels. According to Lawler, such schemes can be evaluated according to the:

- Effectiveness in creating the perception that the pay is according to performance
- Negative side effects (social ostracism of good performers, defensive behavior, false data about performance)
- Encouragement of employee cooperation
- Acceptance by employees

Lawler's review of performance-related pay leads to the following conclusions:

- Individual based schemes perform better than group and organization wide schemes in creating the perception that pay is tied to performance. In the latter cases, important influences on an individual's behavior and performance are exogenous to the control of individuals.
- Individual schemes based on objective measures of performance produce the strongest perceived connection between pay and performance.

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- Individual bonus and incentive schemes at the non-management level are likely to produce negative side effects, particularly in situations of relatively low trust and where the performance is subjectively based.
- Group and organization wide schemes are generally rated higher than individual based schemes in generating employee cooperation.
- Employee acceptance of all performance based schemes is only relatively moderate, with the least acceptance being for individual based schemes because of the perceived difficulties of administering them fairly and encouraging competitive relationship between employees.

The key requirements for performance-based pay are as follows:

a) **Trust in management:** A trust in the management of an organization is very essential is this context.

b) **Absence of performance constraints:** Variables exogenous to the control of individual employees because of interdependent jobs or external circumstances are the primary concern in this type of pay.

c) **Trained supervisors and managers:** Training is required in the skills of the performance appraisal process.

d) **Good measurement systems:** The information systems which underlie the process of performance appraisal need to contain objective information on the specific requirements and outcomes of individual jobs.

e) **Ability to pay:** The merit component of the salary increase budget must be sufficient to motivate the performance and fund the increase.

f) **Valid job evaluation and externally competitive pay levels:** Merit pay increments must be integrated into a larger set of reward arrangements in accordance with the internal and external equity.

g) **Distinction between cost of living, seniority and merit:** Evidence needs to be provided as per the relative proportions contributed by each of these sources to an overall wage increase.

h) **Open pay policy:** Employees must clearly understand the workings of the arrangement.

i) **Flexible reward schedule:** The importance of the timing of a merit increase may argue for different merit dates for different group of employees.

j) **Consistency with the prevailing culture:** A consistency with the prevailing culture is a key component in the context of performance-related pay.

Check Your Progress

6. Enumerate the four stages of a stock option scheme.
7. List any three key requirements for performance-related pay.

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8.6 NON-MONETARY INCENTIVE SCHEMES

Non-Monetary rewards are the benefits given to the employees of the organization to increase the employees' job performance and their loyalty towards the organization. The non-monetary rewards does not involve direct money. The employees do not get any money, instead they get various benefits like promotions, food, company uniforms, flexibility in time, healthcare benefits, life insurance policy for family, etc. In many studies, it has been found that the benefits, which are in non-financial or non-monetary form are more beneficial to the organization because it involves some form of emotional bonding as well as familiarity with the employees, which can increase employees' loyalty, that in turn increases job performance. A non-monetary reward also includes any material object such as jewellery, precious metals, or any recognition. Examples of non-monetary compensation include benefits, flex-time, time off, free or discounted parking, gym membership discounts, mentoring programs, tuition assistance, and childcare. A benefit plan is designed to address a specific need and provided in a non-cash or non-monetary form. Non-financial rewards are designed to acknowledge a special attainment that acknowledges an employee's outstanding job performance in the organisation. The pinnacle of a special research project or graduation from a training program that leads to a desirable certification of the employee for doing an excellent job. Some of the favourites among the employees are as follows:

- Healthcare benefits
- Life insurance
- Promotion
- Vehicle or vehicle allowance

8.6.1 Types of Non-Financial Incentives

There are several types of non-financial incentives or rewards such as recognition, benefits, opportunity, and flexibility. The following Table 8.4 list the types of non-monetary incentive schemes.

Table 8.4 *Types of Non-financial Incentives*

Recognition	Reward	Opportunity	Flexibility
1. Award presentation in front of peers	1. Vouchers	1. Chance to lead teams and tasks	1. Paid personal days
2. Dinner with CEO	2. Prizes	2. Paid training	2. Flexible scheduling
3. Enhanced decision making	3. Gift cards	3. Promotion	3. Telecommunication
4. New office or up-graded work space	4. Paid parking or transit pass	4. Mentorship program	4. Option to stop working on the least favourite task

Planning Non-financial Incentives

Effective non-financial incentives for employees touch the emotional side of employees making them feel more welcomed, appreciated, and valued. Employees respond well to non-monetary incentives. Non-monetary incentives for employees should not be insulting. If they do, they will be more deleterious than helpful because they will produce indignation. Investing in the workforce in creative ways is one of the best ways for companies to retain talented employees and create a sustainable culture of success.

Advantages of non-monetary incentives

Non-monetary rewards can be very motivating; they can help to build feelings, confidence, and satisfaction with regards to each other. There are several advantages of non-financial incentives:

I. **Refreshing:** Non-financial rewards do not have to be sumptuous. Taking an employee to lunch shows that the organization cares about the employees beyond the office. It is a nice change of scenery, definitely better than sitting at a desk throughout the day. For this reason, the employees return to work the next day more refreshed and enthusiastic about their work.

II. **Team bonding:** Employees get stressed out just as much as managers do. When the employees become completely exhausted due to work overload and it becomes difficult for them to produce outstanding work. Events are great non-financial rewards. A work party not only calm the tired employees but also make them comfortable amongst colleagues. It will also help to build confidence, which is the key for success in the workplace.

III. **Increased job performance:** Employees are appreciated for their work performance. In addition to their performance, recognition can be much more desirable than any monetary benefits. Their outstanding job performance can be posted on social media. This will fill the employees with a feeling of pride and ownership of their work. There is a wave effect to their recognition. Other employees will crave similar recognition and thus, will give more effort into their own work to get the desired attention.

IV. **Positive change:** The employees make their choices and sacrifices to get to work on time every day. They also have bills to pay, unexpected occurrences, and families of their own, which make their life more exciting and interesting. Therefore, it is essential to know them. To discuss business strategy, talk to them about something deeper instead of simply talking in a formal manner. This shows that the organization cares about their employees. As a result, a positive change in their personality will take place.

V. **Encouraging:** When a company is well and stable, it is usually the result of an employees' work and team effort. If the company exceeds their sales goals for the month, then they should organize a fun activity for employees

such as an event outing or a company trip. Other options include day off or a spa package. This will encourage the employees to do better. If employees consistently rise beyond expectations, then they should be allowed to work from home for some hours per week or to leave a bit earlier.

VI. **Growth of employees and organization:** Team meetings and group discussions are helpful for the employees in the organization. Taking time out of the day to schedule time for one on one meetings shows employees that they are valued, along with their input in work.

Disadvantages of non-monetary incentives

Non-monetary incentives also have drawbacks or disadvantages. They exist as the business owner neglects to:

- Ensure that the incentives are attractive to the employees. A weekend sports package or a Las Vegas getaway may not be up the alley of an employee who has never snapped on ski boots.
- Do their homework when selecting employee incentives or rewards, with due consideration towards budget constraints.

8.6.2 Relevance of Non-Monetary Incentives

Captain Rahul Sharma, Sr. Vice President and Head of Human Resources and training in DHFL housing finance group has rightly said 'employers need to touch the employees heart, mind and soul by engaging the employees in the workplace which leads to motivated employees and better performance'. Human resource managers need to provide various monetary rewards such as bonus, performance incentives, regular rewards, recognition, progression and promotion regularly. Managers need to use a combination of all these incentives to keep the employees motivated and enthusiastic. Psychologists have suggested the use of these incentives since quite long.

According to K. Mahabub Ali, Faculty and Psychological Counsellor at the National Industrial Security Academy CISF, 'not getting appreciation or acknowledgement, in other words what we call it as strokes in psychological parlance, the employees will become stroke hungry, which would affect the motivation and morale of the employees. As the stroke is defined as a unit of human recognition that gives us stimulation, every organization must adopt it as a policy from top to bottom to encourage the habit of giving positive strokes, as it will lead to potential blossoming leading to more and more motivation and productivity.

Most of the new employees believe that remuneration is the top most priority in their life style and career advancement. However, as they commenced on their career, they realize that the factors such as professional success, competitive atmosphere, integrity, passion, and recognition in their work place are more important in keeping them motivated and determined.

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Check Your Progress

8. What are some of the favourite non-monetary incentive schemes among the employees?
9. State the examples of non-monetary compensation.

8.7 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. According to Milkovich and Newman, job evaluation is 'a systematic procedure designed to aid in establishing pay differentials among jobs within a single company. It includes classification, comparison of the relative worth of jobs, blending internal and external market forces, measurement, negotiation, and judgment.'
2. Non-analytical job evaluation process compares the whole job, for the purpose of placing them in a grade or a rank order. In this process the factors or elements are not analyzed.
3. The two methods of job ranking are:
   (a) Alternate ranking method
   (b) Paired comparison method
4. The methodology used by point approach in job evaluation includes the following:
   a) Selection of factors
   b) Factor plan design
   c) Job or role analysis
   d) Evaluating jobs
5. Writing class descriptions is challenging because being precise in defining a class will surely help in making the evaluation more reliable, but at the same time, it will also limit the number of jobs which can be classified. Therefore, writing class descriptions can be a tight rope walk.
6. The four stages of a stock option scheme are as follows:
   a) The granting of stock to the employee
   b) Vesting (minimum holding period specified for the stock)
   c) The exercise of option
   d) The sale of the shares acquired through the exercise of options
7. The key requirements for performance-related pay are:
   a) Trust in management

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b) Absence of performance constraints

c) Trained supervisors and managers

8. The favourite non-monetary incentive schemes among the employees are as follows:
   a) Healthcare benefits
   b) Life insurance
   c) Promotion
   d) Vehicle or vehicle allowance
9. The non-monetary compensation include benefits, flex-time, time off, free or discounted parking, gym membership discounts, mentoring programs, tuition assistance, and childcare.

8.8 SUMMARY

- Job evaluation is a process of determining the relative worth of a job. It is a process, which is helpful even for framing compensation plans by the personnel manager.
- Job evaluation is concerned with assessing the value of one job in relation to another. Numerous definitions of job evaluation have been provided by different scholars and authorities.
- According to ILO report, 'the aim of majority of systems of job evaluation is to establish, on an agreed logical basis, the relative values of different jobs in a given plant or machinery, i.e., it aims at determining the relative worth of a job.'
- For putting the job evaluation programme into practice, certain principles have to be considered or taken into account. The principal focus of job evaluation process is to determine the relative worth of the jobs within an organization.
- A systematic comparison of existing jobs in an organization helps in establishing a job hierarchy which ranks jobs in terms of their relative contribution to the organizational objectives.
- Over the past two decades, employee incentive pay schemes have assumed a greater importance as a component of compensation package.
- According to Towers Perrin survey, despite the existence of various forms of equity based incentive schemes like share incentive plans, cash based profit sharing, employee stock purchase plans, etc., most or rather an overwhelming number firms in the US used incentive pay schemes which rely on stock options.

- Non-Monetary rewards are the benefits given to the employees of the organization to increase the employees' job performance and their loyalty towards the organization. The non-monetary rewards does not involve direct money. The employees do not get any money, instead they get various benefits.
- There are several types of non-financial incentives or rewards such as recognition, benefits, opportunity, and flexibility.
- Captain Rahul Sharma, Sr. Vice President and Head of Human Resources and training in DHFL housing finance group has rightly said 'employers need to touch the employees heart, mind and soul by engaging the employees in the workplace which leads to motivated employees and better performance'.

8.9 KEY WORDS

- **Job evaluation:** It is a systematic procedure designed to aid in establishing pay differentials among jobs within a single company.
- **Job ranking:** Job ranking compares the whole jobs with one another and hierarchically arranges them according to their size and value to the organization.
- **Job classification:** It is a non-quantitative technique of job evaluation in which the whole job is analysed with a pre-determined standard.
- **Point method:** It is a quantitative approach to job evaluation, which involves breaking down of jobs into components or key elements.
- **Stock options**: Incentive schemes which provide an employee with the right to purchase company stock at stipulated price over a specific period of time.
- **Non-qualified stock options:** It is a type of stock option plan which is not bound by the statute or government regulations concerning minimum price requirements, maximum grant periods or maximum exercise and holding periods.
- **Incentive stock option:** These are stock option plans which are subject to several restrictive statutes and tax regulations.

8.10 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. What are the aims of job evaluation according to Michael Armstrong?
2. Why are job evaluation methods important?

3. Write a short note on job classification method.
4. Illustrate stock option schemes with the help of an example.
5. What are the disadvantages of non-monetary incentives?

Long Answer Questions

1. Explain the features of job evaluation.
2. Describe the principles and procedure of job evaluation.
3. Discuss the point method of job evaluation.
4. Evaluate the advantages and disadvantages of Stock Option Plans.
5. Elucidate the disadvantages of non-monetary incentives.

8.11 FURTHER READINGS

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BLOCK - III

KPP AND PERFORMANCE COMPENSATION

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UNIT 9 PERFORMANCE LINKED COMPENSATION

Structure

9.0 INTRODUCTION

Performance linked compensation or pay for performance is a salary or payment or wages paid system that is based to position the individual or team according to their work associated with their pay band. It is a financial reward system for employees where some or all of their monetary compensation is associated with their performance of the work ability or service criteria basis. There are several benefits of a performance linked compensation including effective job pricing, employee motivation, more focus by employees, increased job retention, effective tactic for dealing with poor performance, achievement of clearly defined job framework and enhancement of better job and performance culture. But simply providing monetary benefit is not enough for motivating and attaining loyalty from the employees, and other methods of motivation as well as important corporate recognition and communication must also be coordinated with performance linked compesation to fully reap its benefits. The companies looking to acquire and retain a talented pool in the age of information laced with economic uncertainities are increasingly turning towards performance linked compensation plans. In this unit, you will learn about different elements related to performance linked compensation.

9.1 OBJECTIVES

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After going through this unit, you will be able to:

- Describe the performance pay system
- Explain the techniques of measuring performance
- Discuss the measurement, problems and prospects of Key Performance Parameters
- Examine the implementation of job evaluation
- Describe the determinants and objectives of incentives
- Discuss the classification of rewards

9.2 PERFORMANCE PAY SYSTEM: OVERVIEW

Performance for pay can be used in a business purpose for an individual, a team or the entire company that related to performs during a stipulated time format. Performance linked compensation systems provides financial compensation that focuses on individual, team or group performance.

The performance linked compensation or incentives (PLI) is a form of payment to an employee from an employer, which is directly related to the performance output of an employee and that may be specified in an employment commitment.

There are different types of payment schemes that apply to performance pay systems, which are designed to distribute financial rewards to employees. In contrast with set salaries, performance pay is based on compensating the employee per their individual contribution, not the value of the position itself. There is individual performance pay, which is often associated with sales personnel who depend on commissions, and skill-based pay, in which compensation is connected to competency. Some companies engage in profit-sharing, which means that employees will receive a certain percentage of the company's financial gains.

- **Skill-Based Overview:** Many manual labour and manufacturing companies favour skill-based pay systems that link aptitude and expertise to pay grades. This promotes productivity, better workforce skills and product quality. There are two types of skill-based payment systems. First, there are general skill systems that increase the employee's ability to perform more tasks and positions. Second, there are specialized skill systems that compensate employees for master's highly difficult tasks. An employee who learns how to operate similar machinery would be rewarded through the general skill system; an employee who learns an entirely new machine would be incentivized through a specialized skill system.

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- **Benefits:** Performance pay offers a variety of benefits. Management enjoys better employee performance and employee engagement. As long as there is a fair and effective performance review system that is accurately aligned with local salary levels, employees will strive to work hard. Executives will enjoy increased revenue and working capital. Management can use performance pay systems to transition model employees into supervisors. Human Resource administrators can use performance pay to attract potential job applicants and improve employee retention. In the beginning, turnover rates may be slightly higher as low performers leave, but qualified and motivated employees will remain.
- **Disadvantages:** Some companies struggle to implement performance pay systems because it is hard to define performance levels and objectively evaluate employees. The performance criteria and measurements may be vague and inadequate. As a result, supervisors favour certain employees over others, which increase collective employee dissatisfaction. When employees cannot understand the performance measures, they may still blame management when they fail to receive wage increases. Sometimes, the objective of performance appraisal systems is to merely identify training needs or promotion suitability. The biggest challenge of performance pay systems is that management must continually observe and document employee performance while also providing feedback, which is very time consuming.
- **Performance criteria:** The actual pay scheme will determine the performance criteria, which may be based on individuals, groups, the organization or a customized mixture. Some individual-based criteria focus on the achievement of personal goals and the supervisor's feedback. Individual training goals may be based on specific skills and knowledge needed to perform work duties. Individual performance systems are not recommended when the company's objective is to increase teamwork performance and information sharing. Other systems utilize peer reviews, which are often considered to be highly subjective.

9.2.1 Measuring Performance

A number of different performance appraisal methods or techniques are available for evaluating the performance of the employees. These methods try to explain how management can establish standards of performance and devise ways and means to measure and evaluate the performance. There is no foolproof method of evaluating the performance of employees. Every method suffers from certain drawbacks in spite of some merits. These methods can broadly be divided into traditional and modern methods.

The traditional methods constitute the old methods of performance appraisal which are based on personal qualities like knowledge, capacity, judgement, initiative,

attitude, loyalty and leadership, etc. Modern methods are an improvement over the traditional methods. Modern methods are an attempt to remove defects from old methods.

TRADITIONAL METHODS

1. Unstructured method
2. Straight ranking method
3. Paired comparison method
4. Man-to-man comparison method
5. Grading method
6. Graphic rating method
7. Forced choice method
8. Checklist method
9. Weight checklist method
10. Free essay method
11. Critical incidents method
12. Field review method
13. Confidential reports
14. Forced distribution method

MODERN METHODS

1. Behavioural Anchored Rating Scale method (BARS).
2. Result-oriented appraisal or MBO method
3. Assessment centre method
4. Human resource Accounting method
5. Psychological appraisal method
6. 360 degree appraisal

Fig. 9.1 *Measuring Performance for Businesses*

Firms are increasingly presented financial and non-financial performance measurement for their sub unit of their balance scorecard and their other perspectives are:

- Financial
- Customer
- Internal business process
- Learning growth

Firms are assumed that the improvement of learning and growth will leads to improvement for internal business process. Improvement of internal business process is to lead the improvement factor of financial and customer dealing procedure.

Different performance measures compensation: There are four main perspectives to choosing the different performance measures compensation that an economic performance as follows:

(i) Return on investment(ROI)

(ii) Residual income

(iii) Economic value added

(iv) Return of sales

Let's have a look at each of these performance measures in detail.

(i) Return on investment(ROI): Return of investment is an accounting measure of income divided by an accounting measure of the investment. Return on Investment (ROI) is a performance measure used to evaluate the

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efficiency of an investment or compare the efficiency of a number of different investments. ROI tries to directly measure the amount of return on a particular investment, relative to the investment's cost. To calculate ROI, the benefit (or return) of an investment is divided by the cost of the investment. The result is expressed as a percentage or a ratio.

The formula of ROI is **"ROI =(Current Value of Investment - Cost of Investment) / Cost of Investment".** In the above formula, "Current Value of Investment" mentioned to the proceeds that Obtained from the sale of the investment of the interest. ROI is measured as a percentage, that it can be easily compared with returns from other investments. The most popular criterion are two reason as follows:

- It are blends all the interest of the profitability (revenue, cost, profit, investment) into single percentage.
- It may also be compared by other ROI's in both inside and outside of the firm.

It are also called Accounting rate of return (ARR) or Accrual accounting rate of return (AARR).

$$\text{ROI} = \frac{\text{Operating income} \times \text{Revenue}}{\text{Total assets} \times \text{Revenue}}$$

$$\text{or, ROI} = \frac{\text{Revenue}}{\text{Total assets}} \times \frac{\text{Operating income}}{\text{Revenue}}$$

$$\text{or, ROI} = \text{Investment turnover} \times \text{Return on sales}$$

This calculation method are known as Dupont method of profitability Analysis.

(ii) Residual Income: Residual income is an account of the measuring part of the income minus a minimum amount of the required amount of the accounting measure of interest. Residual income is also the amount of net income generated in excess of the minimum rate of return. It has been used in a number of contexts, including as a measurement of internal corporate performance whereby a company's management team evaluates the return generated relative to the company's minimum required return. Alternatively, in personal finance, residual income is the level of income that an individual has after the deduction of all personal debts and expenses have been paid. The formula of RI is **"RI = Income – (RRR x Investment) – RRR = Required rate of return".**

(iii) Economic Value Added (EVA): Economic value added (EVA) is a measure of a company's or firm's monetary performance that based on the residual wealth calculated by deducting its cost of capital from its operating profit, which adjusted for taxes on a cash basis. EVA can also be mentioned to as economic as it attempts to capture the true economic profit of a company. This measure was devised by management consulting firm Stern Value Management, originally incorporated as Stern Stewart & Co. EVA is a

specific type of residual income calculation that has recently gained popularity. The calculation of the weighted-average cost of capital equals the after-tax average cost of all long-term funds that in utility.

(iv) Return on sale: Return on sale is simply income that divided by sale. Return on sales (ROS) is a ratio used to evaluate a company's operational efficiency. This measure provides insight into that how much profit is being produced per dollar or rupees of sales. The ROS is increasing indicates that a company is growing more efficiently, in meanwhile a decreasing ROS could signal imminent financial troubles.

Check Your Progress

1. What is individual performance pay associated with?
2. State the biggest challenge of the performance pay systems.
3. What are the qualities on which the old methods of performance appraisal are based?

9.3 KEY PERFORMANCE PARAMETER (KPP)

Key Performance Parameters (KPP) are key capabilities that must be met in order to meet its operational goals. If an attribute is considered important but not critical to meeting system goals, it can be classified as a key system attribute(KSA).

Key performance indicator: The profits are only one of the many factors affecting your company's balance sheet. Key performance indicators (KPI) refer to the values used to assess a business' success in reaching its goals. In the long run, tracking relevant KPIs can help you make important decisions about your company's growth and development. In this section, you will first have a look at the key performance indicators for businesses and then study about these indicators for employees.

Here are seven of the most important KPIs to track as a small business owner.

- **Cash Flow Forecast:** Cash flow forecast let businesses assess whether their sales and margins are appropriate, and are consequently one of the most important KPIs for small businesses to track. To make your cash flow forecast, add the total cash your business has in savings to the projected cash value for the next four weeks, then subtract the projected cash out for the next four weeks.

  Savvy business owners perform regular cash flow forecasts so they can identify problems in the early stages and make any necessary adjustments. Along with helping businesses anticipate upcoming surpluses or shortages, a cash flow forecast is crucial for tax planning and upcoming loan applications.

- **Gross Profit Margin as a Percentage of Sales:** No business can achieve success if it's paying out more to suppliers than it's netting in sales each month from customers. Gross profit or net profit margin as a percentage of sales is an expression of total profits as they compare to revenue.

  First, find your business' gross profit margin (GPM) by dividing your gross profit amount by your sales. Take that, multiply it by 100, and you will have your gross profit margin as a percentage. Next, to find out how much of your GPM makes up your overall sales, divide that value by your sales amount. Here's an equation for easier reference.

  (Gross Profit/Sales x 100) / Sales

  The benefit of tracking this KPI over time is that you can easily quantify how much money you're keeping against the amount paid out to suppliers. As businesses retain more money, gross profit margin increases. But a decrease in gross margin as a percentage of sales could indicate that a business is overspending on its supplies. Owners would need to reduce overhead increase prices on goods and services to compensate.

- **Funnel Drop-Off Rate:** Your funnel drop-off rate assesses the number of visitors who abandon a conversion process or sales funnel prior to completion.

  For the uninitiated, imagine a sales funnel as an actual funnel pointed downward. The top of the funnel is the widest part of it, and represents the entry point for a customer to first get acquainted with your company or product. To calculate funnel drop-off, start by finding the number of visits of a particular conversion step, then subtract the number of visits of the first step. Divide the new value by visits of the first conversion step. By identifying when prospective buyers abandon the conversion process, companies can identify problems and make necessary adjustments to boost sales. With so many small businesses relying on the internet as a sales tool, funnel drop-off rate has become one of the most crucial performance indicators to track.

- **Revenue Growth Rate:** It might be obvious, but the revenue growth refers to the rate at which a company's income, or sales growth, is increasing. To find revenue growth rate, begin with your business' total revenue for the current year. Next, divide current revenue by total revenue from the previous year to find the rate of growth. By calculating revenue growth rate regularly, you can assess whether growth is increasing, decreasing, or plateauing. Use it to make any necessary changes to stay profitable.

- **Inventory Turnover:** Inventory turnover measures the number of times inventory is sold or used in a given period of time, and is valuable because it reveals a business' ability to move goods. Inventory turnover can be found by adding up the cost of sold inventory, then dividing that total by the value of the remaining at year's end. While it's only natural for businesses to

pursue a high turnover rate, companies should be wary of achieving this goal by reducing prices too significantly. Calculating your inventory turnover ratio can help you measure and plan for adjustments in inventory as needed.

- **Accounts Payable Turnover:** A business can't keep its door open for long if it fails to pay suppliers. Accounts payable turnover is a measure of the rate at which your business pays for goods and services, revealing the amount of cash spent on suppliers in a given period. To find accounts payable turnover, add up the cost of total supplier purchases and divide by average accounts payable. Once you know how much you spend on suppliers, you can determine if steps need to be taken to reduce spending, which should boost long-term profits for your business.
- **Relative Market Share:** One of the most crucial performance indicators, relative market sharing shows that how much of a given market is controlled by your business as a percentage. After finding your own market share, subtract this value from 100 to find the percent of the market controlled by other businesses. Then divide your market share by the percentage of the market not controlled. By multiplying the result by 100, a company can find its relative market share.

  Unlike internal metrics, relative market share reveals how a company is performing relative to its competitors in the same space. After all, a small bump in profits may matter less if your company is falling behind its competitors. Once you calculate your relative market share, you can make strategic adjustments to your product and service offerings to improve long-term profitability for your business.

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Implication

Every small-business owner has to balance the need to maintain adequate internal controls with budgetary constraints. An effective internal control system is vital to making sure that meet the long term business goals, the cost implications of some controls makes including them in system unwise. Contemplates the costs of implementing internal controls against their potential the direct and indirect benefits when creating and implementing a small-business internal control system.

- **Direct Cost Implications:** The most obvious cost implications focus on how internal controls can affect your annual budget. Direct costs, such as hiring additional employees to achieve adequate separation of duties or automating business systems to increase information security, are sometimes too expensive for your budget to handle. As a result, small-business owners often must substitute less costly and less effective controls and make allowances to increase their effectiveness. For example, you can conduct surprise internal audits and create clear, specific information security and storage procedures.

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- **Indirect Cost Implications:** Indirect costs associated with implementing internal controls can affect efficient operations and productivity. For example, manual cash management controls, including transaction verification, payment authorization and account reconciliation procedures, may decrease efficiency so much that your employees find work-around to outwit manual controls. For these reasons, it's important to include indirect cost implications in deciding how to design and implement an internal control system.
- **Direct versus Indirect Cost Implications:** In some cases, direct financial cost implications make it seem that implementing some internal controls is not possible. You should also consider the potential indirect costs associated with disregarding or implementing less effective controls. After conducting a thorough cost-benefit analysis, you might wonder whether you can afford not to implement strong internal controls. When it comes to designing and implementing strong internal controls, the cost implications of non-compliance with federal and state regulations, or the cost to repair a damaged reputation, often make investing in preventive controls a significantly better option.

Employee Related Key Performance Indicators

Performance measures may be objective or subjective.

(i) *Objective performance measures:* Objective performance measures are indications of job performance that can be verified by others and are usually quantitative. Objective criteria include:

- Quality of production
- Degree of training needed
- Accidents in a given period
- Absenteeism
- Length of service, etc.

(ii) *Subjective performance measures:* Subjective performance measures are ratings that are based on the personal standards of opinions of those doing the evaluation and are not verifiable by others. Subjective criteria include:

- Ratings by supervisors
- Knowledge about overall goals
- Contribution to socio-cultural values of the environment

Problems and Prospects

Performance measurement is the process of putting metrics in place that employees need to meet, and then analysing the actual employee performance against those metrics. While this sort of data can be excellent for determining the efficiency of an employee, problems with performance measurement that a manager needs to consider do exist.

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Some of the problems and solutions associated with performance management include:

- Manager not skilled at evaluating: This might become one of the basic problems affecting the entire measurement proceess. The rating must be in tandem with the compensation policy and the managers must be properly trained about the company's policy as well as the technicalities of the evaluation process.
- Fauly standards: In case the standards are not realistic, attainable, timely or sense-making, then the entire process might fall flat. This might also be problematic in case the standards are not communicated to the employees in time. Both the situations will lead to an inaccurate and inrrelevant evaluation.
- Money not the only motivator: There might be a scenario where the employees are not motivated by any raise in the salary or compensation. They might actually have been needing recognition, praise or even better role. In such cases, the usual performance measurement might not be helpful at all.
- Incomplete picture: There can be scenario where the employee is meeting the company numbers but is failing to satisfy the consumer wants in terms of services. Therefore, the assessment of his performance will be incomplete.
- Quality may be ignored: In case the performance management system fails to include the benchmark related to the quality of work and relies purely on quantifiable data then the true analysis of work will be incomplete and the results of the measurement might actually be faulty.
- Individual and the System: There might be instances where the employee is performing well but the system overall is not, or vice versa. In such case performance measurment may be considered to give a non-authentic picture of the performance.

Check Your Progress

4. How is gross profit margin related to business's assessment of spending?
5. What are subjective performance measures?

9.4 IMPLEMENTATION OF JOB EVALUATION

You have already learnt about job evaluation in the previous units. The idea will recapitulated here. Job evaluation is the basis for fair and equitable compensation in relation to the value of the work that an individual does. Equity or fairness can be defined in the following ways:

- External pay equity is when a person is paid fairly in relation to those who perform similar jobs in other organizations.

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- Internal pay equity is when a person is rewarded fairly according to the relative value of their job within the organization.

Job evaluation is a method that supports external and internal pay equity. It helps identify and remove wage inequities and provide internal equity by creating a fair and objective wage structure. The wage structure is created jointly, by union and management, with consideration to market salary surveys, aiding in achieving external pay equity. Job evaluation is a method of making sure that each job is recognized for duties and requirements, and is appropriately compensated. It is designed to assess the job, not an individual's performance.

With job evaluation, both union and management agree to jointly negotiate, implement, and maintain a job evaluation program, setting out a Terms of Reference. The Terms of Reference will form part of the union collective agreement. The Terms of Reference documents the program structure including the committees, how information is gathered, how jobs are rated, and what the established appeal process will be if an employee disagrees with the rated results. It includes clear goals and clear language agreed to by all parties. The employee has a say in the process by having the opportunity to jointly author the job description, or Job Analysis Questionnaire, with their supervisor, which will then be rated by a joint committee to determine its worth in comparison to other jobs within the organization.

Implementing the Job evaluation program: There are several step for implementing the job evaluating program as follows:

- Program Planning: Jointly establishes the Terms of Reference, evaluation criteria, and committees.
- Training: For the employee and evaluation committee members on the process and how to complete a job analysis questionnaire.
- Job Analysis and Job Description Writing: Completed by the employee and their supervisor.
- Job Evaluation Plan Validation: To confirm equity.
- Rating: Completed by a committee as prescribed in the Terms of Reference with selected members from the union group and management.
- Implementation: Notification of the rating and pay changes made.
- Maintenance: This Process is established by capturing the changes in an individual's job for ensuring the value is accurate.

9.5 INTRODUCTION TO INCENTIVE PAYMENTS AND ITS OBJECTIVES

Incentive payment refers to a payment for stimulating the greater output or investment or to encourage someone for taking part of an activity. A monetary gift

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provided to an employee based on performance, which is thought of as one way to entice the employee to continue delivering positive results. Incentive pay may come in the form of a bonus, profit-sharing, or commission. Incentive pay refers to giving employees bonuses or other forms of compensation in exchange for going above and beyond their normal duties. It is used as a way to incentivize employees to continue doing excellent work. A cash bonus toward the end of the year for the holidays is a common form of this benefit, and some employees are capable of earning a commission by making sales, which would also fall under incentive pay. Employers can also reward workers for superior performance by offering casual incentives. This refers to giving workers non-monetary items such as gifts or paying for an employee's lunch. The definition of incentive is something that makes someone want to do something or work harder. An example of incentive is extra money offered to those employees who work extra hours on a project.

Objectives of Incentive Payments

An essential part of running a successful business is motivating employees and finding ways to make their incentives fall in line with the incentives of the company. Many companies offer employees special incentives such as bonus pay, commissions and fringe benefits with certain goals in mind, such as increasing productivity or morale. The underlying objective of special incentives is often to boost company profits.

- **Increasing Productivity:** The more work employees accomplish, the more revenue a company is likely to make, which leads to higher profits. Many incentives that businesses offer to workers revolve around increasing productivity. For instance, companies often offer commissions to salespeople, which means the sales staff receives pay based on a certain percentage of the sales they make. This can motivate salespeople to work harder and make as many sales as possible. Similarly, companies sometimes offer bonuses at the end of the year to especially productive workers. This can motivate employees to work harder in the hopes of getting a bonus.
- **Improving Safety:** In businesses that hire physical labourers, such as manufacturers and building contractors, worker safety is an important issue. When workers are hurt on the job it can cost employers a lot of money, both in terms of workers' compensation and lost productivity. Employers can offer special incentives to workers who promote safety, such as giving out extra compensation or prizes if workers avoid injuries on the job.
- **Increasing Morale:** Another possible goal of incentives is to improve employee morale. The pay and other benefits workers receive for doing a job can determine how happy they are with their jobs. For instance, if a salaried worker puts in hundreds of extra hours of work in a year, a bonus is a way to make him feel like his extra effort was worthwhile. Workers who feel rewarded for their efforts are likely to be happier and more loyal

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to their employers. Increased loyalty can reduce employee turnover and the costs of having to recruit and train new workers.

- **Customer Incentive Programs:** Businesses can also offer incentive programs to consumers as a way to retain customers, increase sales and ultimately increase profit. Examples of common types of customer incentive programs include membership programs that grant customers reduced prices or access to special deals, and points programs in which customers earn points for purchases that they can redeem for cash, prizes or discounts.

9.5.1 Introduction to Determinant of Incentives

Compensation or incentives means the basic returns that an employee obtains from their work. Every organization offers a good compensation to attract and retain the ablest employees on the actual work floor. It is because if the company does not offer an attractive package of compensation, compared to other competitive firms, the efficient employees may leave the firm. Hence, the employees should be compensated adequately. A well-designed job evaluation program helps to determine an appropriate compensation system. There are internal and external factors that can be affect compensation as follows:

Internal factors

- **Objectives of compensation:** Objectives of compensation may be controlling cost, establishing fair and equitable pay structure, attracting and retaining competent human resources, improving motivation and morale, improving labor relation, improving the image of an organization and comply with the legal framework and policies of the organization.
- **Policies of an organization:** Policies of an organization influence compensation. Compensation policy is the policy made by the organization. They serve as guidelines for formulating compensation. An organization can be leader or follower regarding pay.
- **Job evaluation:** Job evaluation states job description and job satisfaction. These two factors determine the compensation to be required for payment. By evaluating a particular job, worth of job was determined. It determines the relative worth of a job in an organization. Job evaluation sets up a predictable and precise relationship among base pay rates for all employment.
- **Employee productivity:** The new trend is to link pay with performance. Productivity determines compensation. Employees abilities and motivation affect productivity.

External Factors

- **Legal consideration:** Government law and regulation affect compensation management and policies. Government influences pay directly through laws,

regulation. Tax implication also influences employees. Legal considerations can be taken as an important determinant of compensation. The government makes various rules and regulations to protect the interests of workers.

- **Market rates:** Nature of demand and supply of various types of personnel determine compensation (wages and salaries). Market wage rates are to be followed. Wage rates will be different in a stable economy than in a depressed economy. Matching for the market rate is a major consideration. It should account for inflationary pressures. Skills in short supply carry the high rate of compensation. Compensation rates should be competitive.
- **Equity consideration:** Equity means fairness in the relationship between what a person does (input) and what the person receives (output). Determination of compensation is reasonably viewed in terms of equity. It should be fair within the same organization of similar jobs. Employees should view it as equitable and valuable. There should be equality between the employees otherwise, they will be demotivated. The rate of compensation should not be determined differently on the basis of religion, gender, caste, race etc.
- **The cost of living:** Aggregate pay can influence purchasing power. Compensation should be adjusted according to the rise of market price rate. The cost of living at the average level may change. It is to be considered to maintain living cost through compensation. The organization should compensate the employee at least to meet the cost of living.
- **Union pressure:** A union is a power and it affects compensation. Union pressure depends on the high rate of compensation through collective bargaining, negotiated pay settlements serve as the basis for compensation. Employees have the legal right to have collective bargaining. They work for all the members of the interest of their class. Generally, compensation is determined to balance the pressure of union and organization abilities.

The incentive intensity of rewards has been linked to higher effort and the attraction of talent. Determinants of incentive intensity for individual rewards have been widely examined, while determinants of incentive intensity for group rewards remain unexplored. Incentive intensity was higher when groups were small, when plans did not need to measure quality, and when management participation was high. Plans embedded in small firms and plans with longevity had higher incentive intensity.

9.6 INTRODUCTION TO CLASSIFICATION OF REWARDS

A reward is a pay provided by an employer to the employees. It is a thing given in recognition of service, effort, or achievement. It consists of packages of pay, benefits, services etc. It can be defined broadly as the material and psychological

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profits for performing tasks in the workplace. Broadly, rewards can be divided into following types: **Intrinsic Rewards and Extrinsic Rewards.**

- **Intrinsic rewards:** Intrinsic rewards are the satisfaction that an individual obtains from the job itself. It means, they are the factors of esteem and self-actualization needs of the employees. The satisfaction one gets from the job itself are its intrinsic rewards. These satisfactions are self-initiated rewards, such as having pride in one's work, having a feeling of accomplishment, or being part of a team. These satisfactions are self-initiated rewards and are fulfilled internally by the employees. These rewards consist of having a pride in work, having a feeling of accomplishment, or being a part of the team etc.
- **Extrinsic Rewards:** Extrinsic rewards are the benefits provided externally. These rewards are provided in term of money and fringe benefits. Extrinsic rewards include money, promotions, and fringe benefits. Their common thread is that extrinsic rewards are external to the job and come from an outside source, mainly, management. These rewards are necessary to fulfil physiological and safety needs of the employees. Such rewards are the results of management policies and procedures of the organization.

Financial Rewards and Non-financial Rewards

- **Financial Rewards:** A financial reward means those direct and indirect payments that enhance an employee's well being. Rewards may or may not enhance the employees financial well being. If they do they can do this directly through wages, bonuses, profit sharing, and the like, or indirectly through supportive benefits such as pension plans, paid vacations, paid sick leaves and purchase discounts. Financial rewards make employee financially sound so that he/she can fulfill his/her material desire. Direct payment consists of salary, wages, commissions, incentives, bonus, allowances etc. Indirect payment includes pensions, medical insurance, paid leaves, paid sick leaves, purchases, discounts etc.
- **Non-financial Rewards:** Non-financial rewards are those employee benefits that do not enhance an employee's financial well-being. Non-financial rewards are potentially at the disposal of the organization. They do not increase the employee's financial position, instead of making the employee's life better off the job, non-financial rewards emphasize making life on the job more attractive. However, such rewards provide more job satisfaction. Preferred lunch hours, preferred office furnishing, parking spaces, impressive job title, desired work assignments, business cards, own secretary etc. are some of its examples.

Performance-Based Rewards and Membership Based Rewards

- **Performance-Based Rewards:** Performance-based rewards are such benefits which are provided on the basis of an employee's job performance ability. The reward depends upon the performance of an individual in the

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actual work floor. Performance-based rewards are exemplified by the use of commission, piecework pay plans, incentive systems, group bonuses, or other forms of merit pay plans. These rewards are exemplified by the use of commissions, piecework pay plans, incentive systems, group bonuses, or other forms of merit pay plans.

- **Membership Based Rewards:** Membership based rewards are those rewards that are paid on the basis of being a member of an organization. membership based rewards include the cost of living increases, profit sharing, benefits, and salary increases attributable to labour market conditions, seniority or time in rank, credentials (such as a college degree or a graduate diploma), or future potential. It means the basis of allocating rewards is employee's organizational membership. Hence, the reward goes to all employees irrespective of their performance.

Check Your Progress

6. What is internal pay equity?
7. Give an example of incentive for increasing morale.
8. State the two factors of job evaluation which determine the compensation to be required for payment.
9. Which type of rewards are money, promotions and fringe benefits?

9.7 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. There is individual performance pay, which is often associated with sales personnel who depend on commissions, and skill-based pay, in which compensation is connected to competency.
2. The biggest challenge of performance pay systems is that management must continually observe and document employee performance while also providing feedback, which is very time consuming.
3. The traditional methods constitute the old methods of performance appraisal which are based on personal qualities like knowledge, capacity, judgement, initiative, attitude, loyalty and leadership, etc.
4. As businesses retain more money, gross profit margin increases. But a decrease in gross margin as a percentage of sales could indicate that a business is overspending on its supplies. Owners would need to reduce overhead increase prices on goods and services to compensate.
5. Subjective performance measures are ratings that are based on the personal standards of opinions of those doing the evaluation and are not verifiable by others.

6. Internal pay equity is when a person is rewarded fairly according to the relative value of their job within the organization.
7. An example of incentive used for boosting morale: If a salaried worker puts in hundreds of extra hours of work in a year, a bonus is a way to make him feel like his extra effort was worthwhile. Workers who feel rewarded for their efforts are likely to be happier and more loyal to their employers. Increased loyalty can reduce employee turnover and the costs of having to recruit and train new workers.
8. Job evaluation states job description and job satisfaction. These two factors determine the compensation to be required for payment.
9. Extrinsic rewards include money, promotions and fringe benefits.

9.8 SUMMARY

- Performance for pay can be used in a business purpose for an individual, a team or the entire company that related to performs during a stipulated time format. Performance linked compensation systems provides financial compensation that focuses on individual, team or group performance.
- The performance linked compensation or incentives (PLI) is a form of payment to an employee from an employer, which is directly related to the performance output of an employee and that may be specified in an employment commitment.
- There are different types of payment schemes that apply to performance pay systems, which are designed to distribute financial rewards to employees. In contrast with set salaries, performance pay is based on compensating the employee per their individual contribution, not the value of the position itself. There is individual performance pay, which is often associated with sales personnel who depend on commissions, and skill-based pay, in which compensation is connected to competency. Some companies engage in profit-sharing, which means that employees will receive a certain percentage of the company's financial gains.
- The actual pay scheme will determine the performance criteria, which may be based on individuals, groups, the organization or a customized mixture. Some individual-based criteria focus on the achievement of personal goals and the supervisor's feedback. Individual training goals may be based on specific skills and knowledge needed to perform work duties. Individual performance systems are not recommended when the company's objective is to increase teamwork performance and information sharing. Other systems utilize peer reviews, which are often considered to be highly subjective.
- A number of different performance appraisal methods or techniques are available for evaluating the performance of the employees. These methods

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try to explain how management can establish standards of performance and devise ways and means to measure and evaluate the performance. There is no foolproof method of evaluating the performance of employees. Every method suffers from certain drawbacks in spite of some merits. These methods can broadly be divided into traditional and modern methods.

- Firms are increasingly presented financial and non-financial performance measurement for their sub unit of their balance scorecard and their other perspectives are:
  - Financial
  - Customer
  - Internal business process
  - Learning growth
- There are four main perspectives to choosing the different performance measures compensation that an economic performance as follows:
  - Return on investment(ROI)
  - Residual income
  - Economic value added
  - Return of sales
- Key performance indicators (KPI) refer to the values used to assess a business' success in reaching its goals.
- Every small-business owner has to balance the need to maintain adequate internal controls with budgetary constraints. An effective internal control system is vital to making sure that meet the long term business goals, the cost implications of some controls makes including them in system unwise. Contemplates the costs of implementing internal controls against their potential the direct and indirect benefits when creating and implementing a small-business internal control system.
- Performance measures may be objective or subjective.
- Equity or fairness can be defined in the following ways: External pay equity is when a person is paid fairly in relation to those who perform similar jobs in other organizations. Internal pay equity is when a person is rewarded fairly according to the relative value of their job within the organization.
- Incentive payment refers to a payment for stimulating the greater output or investment or to encourage someone for taking part of an activity. A monetary gift provided to an employee based on performance, which is thought of as one way to entice the employee to continue delivering positive results. Incentive pay may come in the form of a bonus, profit-sharing, or commission. Incentive pay refers to giving employees bonuses or other forms of compensation in exchange for going above and beyond their normal duties.

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It is used as a way to incentivize employees to continue doing excellent work.

- Compensation or incentives means the basic returns that an employee obtains from their work. Every organization offers a good compensation to attract and retain the ablest employees on the actual work floor. It is because if the company does not offer an attractive package of compensation, compared to other competitive firms, the efficient employees may leave the firm. Hence, the employees should be compensated adequately. A well-designed job evaluation program helps to determine an appropriate compensation system. There are internal and external factors that can be affect compensation.
- A rewards is a pay provided by an employer to the employees. It is a thing given in recognition of service, effort, or achievement. It consists of packages of pay, benefits, services etc. It can be defined broadly as the material and psychological profits for performing tasks in the workplace. Broadly, rewards can be divided into following types: **Intrinsic Rewards and Extrinsic Rewards.**

9.9 KEY WORDS

- **Key Performance Parameters (KPP):** It refers to the key capabilities that must be met in order to meet the pre-determined goals.
- **Performance linked compensation or incentives (PLI):** It is a form of payment to an employee from an employer, which is directly related to the performance output of an employee and that may be specified in an employment commitment.
- **Job evaluation:** It is the basis for fair and equitable compensation in relation to the value of the work that an individual does.
- **Reward:** It is a pay provided by an employer to the employees. The material and psychological profits for performing tasks in the workplace.
- **Incentive payment:** It refers to a payment for stimulating the greater output or investment or to encourage someone for taking part of an activity.

9.10 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. Give an overview of the performance pay system.
2. What are the different methods of measuring employee performance?
3. Briefly mention the key performance indicators for employees.

4. Mention the steps involved in the implementation of job evaluation.
5. Write a short note on incentive payments and its objectives.

Long Answer Questions

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1. Explain the concept of measuring performance for businesses.
2. Discuss classification of rewards.

9.10 FURTHER READINGS

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UNIT 10 INSTITUTIONAL MECHANISMS FOR WAGE DETERMINATION AND MERIT CUM REWARDS

Structure

10.0 INTRODUCTION

In the Indian context, wage has always been a sensitive issue as it not only affects the economy, but also the society in general. The British Indian government did take interest in labour issues and did legislate on the subject of labour, but most of the interest was focused upon the working conditions and later it was the trade union activities, and not the labour per se, that became the centre of British interest. Wage in the economic sense constitutes the reward received by labour for his efforts; from the social point of view, wages reflect the occupational stratification of the society. The determination of wage is a critical factor since it directly affects the employee satisfaction, retention and motivation. There are some legal and institutional mechanism in every country which provides a framework for an effective and efficient wage determination. In this unit, you will be introduced to some of the institutional mechanisms for wage determination. You will also learn about some of the service benefits which are important for employee morale and therefore the concepts of citation, token of gift as well as promotion will also be discussed in this unit.

10.1 OBJECTIVES

After going through this unit, you will be able to:

- Explain the factors involved in the wage determination process
- Discuss the institutional mechanisms for wage determination
- Describe the concepts of performance parameters and service benefits like merit cum reward, citation, token of gift and promotions

10.2 OVERVIEW OF WAGE DETERMINATION

Wage Determination is the listing of wage rates and fringe benefit rates for each classification of labourers and mechanics.

Wage Determination Process

Wages can be expressed in two ways. When they are expressed in terms of money paid to the worker they are called **nominal wages**. But when they are expressed in terms of their purchasing power with reference to some base year they are called original **wages**. These wages are arrived at by making adjustment in the nominal wages for the rise or fall in the cost of living.

The measuring rod is the **consumer price index number**. This index number is intended to show over a period of time the average percentage change in the prices paid by the consumers belonging to the population group proposed to be covered by the index for a fixed list of goods and services consumed by them. The average percentage change, measured by the index, is calculated month after month with reference to a fixed period. This fixed period is known as the 'base period' of the index; and since the object of the index is to measure the effect of price changes only, the price changes have to be determined with reference to a fixed list of goods and services of consumption which is known as a fixed basket of goods and services.

Important steps for creating this index number are as follows:

(i) Selection of representative commodities consumed by the group.

(ii) Making arrangements for obtaining their price quotations regularly.

(iii) Selecting a base year and converting current prices into price relatives based on the prices of the base year.

(iv) Obtaining a weighted average of the price relative taking the quantities consumed in the base year as weights.

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How wages are determined?

As you have learnt before, there are different theories as to the determination of wages. Economists have developed a number of theories which try to explain that **how wages are determined** on a macro level. The subsistence theory of wages or salary, states that the real wages of unskilled workers always remain at or very little above subsistence level. If real wages rise more than enough to provide a bare subsistence, the population would expand at a greater rate than the increase of food and other necessaries. The growth of population would increase the number of workers seeking jobs and the pressure of the big supply of labour would force wages down again to subsistence level. Thus improvement in real wages can only be temporary. This theory has considerable validity in a heavily populated country with high birth rate like India. The wages of the great majority of workers in our country are still on the subsistence level and may continue to be so until our development programmes cause our rate of productivity growth to become considerably greater than the rate of population growth.

According to the Marginal productivity theory of wages, in every enterprise there is a point beyond which it will not pay the management to engage more labourers. At this point the labourer produces just enough to cover his cost to the employer. All the labourers being assumed to be of the same quality, they will all receive the same wages, i.e., the wages representing the product of the marginal labourer. This is also not correct. In actual practice wages of labourers, even if they are of the same quality, differ.

What then **determines the wages** of a worker? In actual practice it seems to be determined by a number of factors such as the philosophy of management towards wages, region-cum-industry settlements, internal pricing through job evaluation employer's capacity to pay, court judgments, local area going rates, collective bargaining and government laws.

Definition of Wage determination

Determination of an equitable wage and salary structure is one of the most important phases of employer-employee relations. For good industrial relations, each employee should receive sufficient wages and salaries to sustain himself and his dependents and feel satisfied with a relationship between his wages and wages of other people performing the same type of work in some other organization.

The primary objective of wage and salary administration program is that each employee should be equitably compensated for the services rendered by him to the enterprise on the basis of the nature of the job, the present worth of that type of job and the effectiveness with which the individual performs the job.

Usually, the steps involved in determining wage rates are: performing job analysis, wage surveys, analysis of relevant organizational problems forming wage structure, framing rules of wage administration, explaining these to employee assigning grades and price to each job and paying the guaranteed wage.

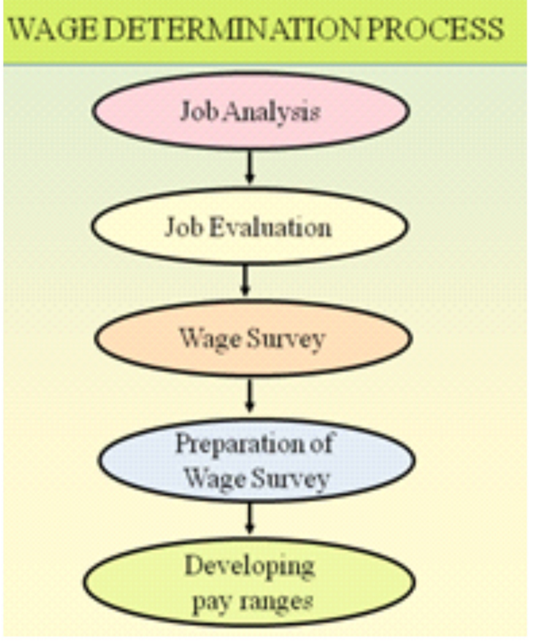

Figure 10.1 *Process of Wage Determination*

Now that you have learnt about the process of wage determination, in the next section, you will study about the institutional mechanisms involved in the process of wage determination.

Check Your Progress

1. What are the factors which affect the determination of wages in actual practice?
2. State the primary objective of wage and salary determination.

10.3 INTRODUCTION TO INSTITUTIONAL MECHANISMS FOR WAGE DETERMINATION

Wage determination has a recent history in India, and in fact, it was only as late as 1947, that under Industrial Disputes Act, various tribunals passed awards regulating wages in a number of industries. However, it was in the Industrial Policy Resolution 1948, the Government included two items which had an impact on the wages and these were:

- Statutory fixation of minimum wages in sweated industries
- Promotion of fair wages agreement in more organized industries.

To implement the first item, the Government passed the Minimum Wages Act in 1948, which researched on the same. And to implement the second item,

the Government appointed a Committee on Fair Wages in 1949. Apart from these, the Government established mechanisms for wage fixation.

Institutions like collective bargaining, industrial wage boards, government appointed pay commissions, and adjudications by courts also exist in India. In the following paragraphs we shall discuss the institutional framework for determining wages that exist in India. You have already been introduced to the concept of the institutional mechanism involved in the wage determination process in Unit 1 under 'Wage Determination Rules'. There was mention of National Wage Policy and Wage Boards. Let's study these in detail in this section.

10.3.1 Welfare Legislations

In this section, let's have a look at some of these important welfare legislations in wage determination.

As in most developing countries, in India also reward or compensation components both in the organized and unorganized sector have been sought to be regulated by the government. The main objective behind such government intervention is not only to provide economic and social security to employees but also to attain the socio-economic objectives of the State as spelled out in the preamble of the constitution. In India, the statutory regulations concerning wage and reward not only deal with the components of compensation package *per se* but also attempt to regulate the wage fixation part of compensation or reward. This section will attempt to outline not only the statutory regulations but also will attempt to contextualize the regulations in the process of wage determination and in the determination of compensation components.

The term 'legal' refers to the Constitutional direction and the guidelines established by legislative enactments for fixing wages. These are three primary acts which act as a legal backdrop for all wage-related issues. Apart from the legislations, the judiciary has provided directions in the form of judgements, which serve as guidelines for wage fixation and other wage-related issues.

Before independence, the policy of the Indian government towards labour was characterized by least and occasional interference. It was only when the labour movement started aligning itself with nationalist cause that the government started taking serious interest in wage issues and its regulations. Modern industry started in India in the 1850s with cotton textile mills being established in Mumbai, Ahmedabad, Sholapur, Nagpur and Kanpur. In a similar vein, the Jute industry started growing, hence by the early decades of the twentieth century, India had a sizeable labour population. Prior to 1929, most labour regulations were enacted to regulate the working conditions or to control the Union activities in the industrial units. The significant point in terms of wages came in 1929, when Royal Commission on Labour was appointed in response to the 1928 Convention adopted by the International Labour Organization. The Convention urged the creation of machinery for fixing minimum wages keeping in view a suitable standard of living for workers and related considerations. The Royal Commission was asked to inquire into and

report on existing conditions of labour in industrial undertakings and plantations in British India. Along with other recommendations, the Commission recommended wages and observed that 'every effort should be made to put into operation a policy of standardized wages in the Bombay cotton mills and that in the jute industry early steps should be taken in that direction both for time and piece workers'. Further, it said that, 'Indian industry is not a world in itself, it is an element, and by no means the most important element, in the economic life of the community'. Care must be taken, therefore, to ensure that, in adopting measures for the betterment of the industry or of industrial workers, the interests of the community as a whole are not overlooked'. Despite the interest shown by the Commission, the recommendations gathered dust and were never executed. It was the inflationary effect of the Second World War which caused the British Government to intervene in matters of wages. In order to offset the price rise and to sustain the real wages, the government initiated a system of dear allowance and bonuses to workers. In 1946, the government formulated a three-fold wage policy which recommended the following:

- Statutory prescription of minimum wages in sweated industries and occupations and in agriculture
- Promotion of fair wages agreements
- Steps to secure living wage for workers in plantations

After independence the government initiated a series of legislative measures and other steps to improve the condition of labour in the country. The adjudication machinery set up during the war was suitably modified and incorporated in the Industrial Disputes Act, 1947, and since then it has played an important role in the area of wage fixation. Simultaneously, the government of independent India started developing a coherent wage policy to guide the firms in all labour-related issues including wages. The beginning of wage policy in India can be traced to the Industrial Truce Resolution which was unanimously adopted in 1947. The Resolution stated, that 'the system of remuneration to capital as well as labour must be so devised that while in the interest of the consumers and primary producers, excessive profit should be prevented by suitable measures of taxation and otherwise, both will share a product of their common effort after making provision for payment of fair wages of labour, a fair return on capital employed in the industry and reasonable reserves for the maintenance and expansion of the undertaking'. The Resolution also recommended the setting up of a suitable machinery for the study and determination of fair wages and conditions of labour. The 1950s saw the setting up of numerous commissions, wage boards, tribunals and pay commissions but none could provide the much needed direction in wage policy matters. All these efforts along with the constitutional enactments only served to express the intent of improving the living and working conditions of the labour. The policy direction was laid down in the Article 43 of the Constitution which states that 'the State shall endeavour to secure by suitable legislation or economic organization or in any other way, to all suitable workers, agricultural, industrial or otherwise, work, a

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living wage, conditions of work ensuring a decent standard of life and full enjoyment of leisure and social and cultural opportunities and, in particular, the state shall endeavour to promote cottage industries on an individual or cooperative basis in rural areas'. Besides this, the Article 39 of the Directive Principles of State Policy provides for equal pay for equal work. These constitutional guidelines set the tone for future wage-related issues and compensation components. Let us study some acts related to wages and compensation (Table 10.1).

Table 10.1 Summary of Important Social Security Legislations in India

Social Security Legislations	Objectives	Benefits
Workmen's Compensation Act, 1923	To compensate workers in cases of workplace accidents, resulting in permanent or temporary disablement or death	Compensation for death, permanent total disablement, permanent partial disablement, temporary disablement and occupational disease
Employees' State Insurance Act, 1948	To provide for health care benefits in case of sickness, maternity and employment injury	Sickness benefits, extended sickness benefit, maternity benefit, disablement benefit, dependents' benefit, funeral benefit
Employees' Provident Fund and Miscellaneous Provisions Act, 1952	To provide for employees' provident fund, deposit linked insurance and pension scheme	Provident fund, deposit linked insurance and pension
Maternity Benefit Act, 1961	To provide for maternity relief before and after child birth	Payment for absence up to 12 weeks, benefits for miscarriage and illness arising out of pregnancy
Payment of Gratuity Act, 1972	To provide relief due to loss of income because of retirement	Lump sum payment is made by the employer
Labour Welfare Funds	To protect workers in certain specified employments	Housing, medical care, water supply, educational and recreational facilities

10.3.2 Collective Bargaining

The term 'collective bargaining' was made popular by Sidney and Beatrice Webb, and the term 'relates to those arrangements under which wages and conditions of employment generally are decided by agreements negotiated between the parties.' In practice, collective bargaining is conditioned by factors like the presence and strength of the union within the industry and the economic character of the industry. Bargaining is usually conducted through a union representing the workers and an association representing the interests of the industry of a particular area or a region.

Through bargaining workers settle issues like wages, hours and conditions of employment, but it is usually wages which is the focus of the bargain. With respect to wages, the unions are primarily concerned with:

- General level of wages
- Structure of wage rates
- Bonus, incentives and fringe benefits
- Administration of wages

Following are the factors which affect collective bargaining:

- Strength of the union
- Regional and local labour conditions
- Wage payment methods
- Size of the firm
- Technical efficiency of the firm
- Capacity to pay
- Wage policy of the company
- Union wage policy
- Alternative choices and demands
- The right and capacity to strike

A study conducted by Employers' Federation of India, pointed out that collective bargaining system has been adopted in almost all industries. The study also revealed that industry level agreements have been concluded in jute, textiles, engineering and tea plantation industry. The Bureau of Public Enterprises in India is increasingly attempting to unify collective bargaining in public enterprises. Indian industries are gradually waking up to the idea of using negotiations as a tool to resolve issues connected with wage and working conditions.

10.3.3 Statutory Wage Fixation

The Minimum Wages Act, 1948 provides for machinery for statutory fixation and revision of minimum wages in the scheduled employments, including plantations and agriculture. Though the Act provided for protection of the workers interest, it failed to provide any guidance in matter of content of a minimum wage, factors to be considered while fixing minimum wage, size of family unit for which minimum rates have to be fixed, weightage to be given to cost of living, etc. The Act therefore left it to the individual committees and to the Government to determine the wage content and the criteria. It was Vidyasagar Committee report, 1966 which was the first to suggest the following norms for fixing minimum wages.

- Prevailing wage rates in the employment concerned
- Prevailing wage rates and statutory minimum wage rates in other employments for similar occupations

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- Statutory minimum wage rate of the same employment in adjacent areas
- Family budget surveys of the workers' families employed in such employments in different centers
- Maintenance of information of CPI Nos. and ACPI Nos.
- General economic conditions prevailing in the industry, including the importance of the industry
- Information on nutritional standards and balanced diet in various areas and places
- Number of persons employed in the industry over a period and the reasons for variations, if any
- Categories of employment and the amount of skill required
- Cost of production and labour cost.

Besides the Vidyasagar Committee Report, recently the National Commission for Labour has also made the following recommendations with respect to statutory minimum wages:

- Once the minimum rates of wages are fixed according to the procedure prescribed under the Minimum wages Act, 1948, it is the obligation of the employer to pay the said wages irrespective of the capacity to pay.
- The appropriate government should revise wages prescribed under the provisions of the Act at least once in every three years. If as a result of adverse price situation wage rates require adjustment within three years, the local authority should make such adjustments.
- The schedules to the Act should be periodically revised so that employment which cease to employ sweated labour are deleted from the schedule and such employment which employ sweated labour are added to the schedule. The employment limit for enabling a state government to fix a minimum wage for a particular employment included in the schedule to the Act should be reduced from 1,000 to 500 in the whole State.
- The criteria in regard to minimum wage fixation will necessarily have to be flexible. Laying down a rigid, cash equivalent of the content of a statutory minimum wage whose coverage is essentially transitional under conditions of development would not serve any useful purpose.

Following these recommendations and keeping the Minimum Wages Act as a basis, wages are fixed by statutory bodies in India. Whatever may be the shortcomings of the legislations and wage awards, statutory wage fixation is an important element of Indian wage and salary administration.

10.3.4 Adjudication

In India, judicial adjudication has emerged as an important tool for settling wage disputes, determining wage scales and for standardization of wages and allowances.

The primary function of judiciary was to adjudicate in industrial disputes, but since the majority of disputes concerned wages, the judiciary has started playing an important role in wage fixation. The Industrial Disputes Act of 1947 enables the government to intervene in matters involving disputes between workers and employers. The Act also provides for compulsory adjudication in the case of failure of conciliation proceedings. In the past five decades the High Courts and Supreme Court has adjudicated in various cases and the awards given by these Courts have in effect become guiding principles of wage fixation. The Supreme Court uses the report of Fair Wages Committee as a guideline for granting awards and with respect to wage fixation it emphasized on social justice. This is evident in the case of Crown Aluminum vs. their Workmen*,* where the Court observed that there can be no doubt in fixing wage structures in different industries, industrial adjudication attempts, gradually and by stages though it may be, to attain the principal objective of a welfare state, to secure to all citizens justice, social and economic. The following principles of wage fixation can be identified from the awards of the Courts:

- There is a minimum wage which must be paid, irrespective of the extent of the profits, the financial condition of the establishment or the availability of workmen on lower wages. This minimum wage is independent of the kind of industry and applies to all alike, big and small.
- The wages must be fair, i.e., sufficiently high to provide a standard family with food shelter, clothing, medical care, and education of children appropriate to the workman but not at a rate exceeding his wage earning capacity in the class of establishment to which he belongs. As time passes and prices rise, even the fair wages fixed tend to dip downwards and a revision is necessary. And this disparity should be made up by additional payment of dearness allowance.

One of the important principles of wage determination is the 'capacity to pay' of the firm. In its various judgements, the Court added more meaning to the concept. In case of Express Newspapers Ltd. vs. Union of India dispute, the Court held that the capacity of an industry to pay may mean one of the three things:

- The capacity of a particular unit to pay
- The capacity of a particular industry as a whole to pay
- The capacity of all industries in the country to pay.

The Court observed that:

- In the fixation of rates of wages the capacity of the industry to pay is one of the essential circumstances to be taken into consideration except in cases of bare subsistence or minimum wage where the employer is bound to pay the same irrespective of such capacity.
- The capacity of the industry to pay is to be considered on an industry cum region basis after taking a fair cross section of the industry.

- The proper measure for gauging the capacity of the industry to pay should not take into account the elasticity of demand for the product, the possibility of tightening up the organization so that the industry could pay higher wages without difficulty and the possibility of increase in the efficiency of the lowest paid workers resulting in increase in production considered in conjunction with the elasticity of demand for the product no doubt against the ultimate background that the burden of the increased rate should not be such as to drive the employer out of business. Different tests have been suggested for measuring the capacity of the industry to pay:
- The selling price of the product
- The volume of the output
- The profit and loss in the business
- The rates which have been agreed to by a large majority of the employers
- The amount of unemployment brought about or likely to be brought about by the imposition of the increased wage.

Apart from this landmark judgement, the Supreme Court decisions have laid down the following considerations for determining the financial capacity of the industry:

- The progress of the industry in question
- The prospect of the industry in future
- The existence and extent of profits of the industry
- The nature of demand which the industry is expected to secure
- The extent of the burden and its gradual increase which the industry may have to face.

The Supreme Court has also laid down guidelines for the application of the principle of industry cum region by the industrial courts. While applying that principle the industrial courts must compare the wage scales prevailing in the similar concerns in the region with which it is dealing, and generally speaking, similar concerns would be those in the same line of business as the concern with respect to which the dispute is under consideration. From wage fixation point of view, it was the Killick Nixon Ltd. Vs. Killick and Allied Companies' Employees' Union case, in which the Supreme Court has laid down that the problem of wage fixation should be viewed from the following aspects:

- Condition of the wage scale prevalent in the company
- Condition of the wage level prevalent in the industry and the region
- The wage packet as a whole of each earner in the company with all amenities and benefits and its ability and potency to cope with the economic requirements of daily existence, consistent with his status in society, responsibilities, efficiency at work and industrial peace.
- The position of the company viewed in relation to other comparable concerns in the industry and the region

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- Pre-emptive necessity for full neutralization of the cost of living at the rock bottom of the wage scale if at or just above the subsistence level
- The rate of neutralization which is being given to employees in each salary slab
- Avoidance of huge distortion of wage differentials, taking into reckoning all persons employed in the concern
- Degree of sacrifice necessary even on the part of workers in general interest
- The compulsive necessity of securing social and distributive justice to the workmen
- Capacity of the company to bear the additional burden
- Interest of national economy
- Repercussions in other industries and society as a whole
- The state of the consumer price index at the time of decision
- Forebodings and possibilities in the foreseeable future as far as can be envisaged
- It cannot be contended that unless there is a ceiling on profits, there cannot be a ceiling on dearness allowance.

In matters of wage fixation following is the position of judiciary in India:

- The wage structure has to be fixed on an industry cum region basis having due regard to the financial capacity of the unit under consideration.
- It is ordinarily desirable to have as much uniformity as possible in the wage levels of different concerns of the same industry working in the same region though it may not always be possible to attain this object because of the different financial capacities of different concerns.
- The wages prevailing in an establishment must be comparable with those given to workmen on similar grade and scale by similar establishment in the same industry, or in their absence, in other similar establishments in other industries in the region
- The employees getting the same wages should get the same dearness allowance, irrespective of whether they are working as clerks or members of subordinate staff or factory workmen
- The additional financial burden which a revision of wage structure or dearness allowance would impose upon an employer, and his ability to bear such burden, are very material and relevant factors to be taken into account.

Apart from the above mentioned institutional mechanisms, there are two other very significant bodies which play an important in wage and salary fixation in India. We are treating them independently in a separate section because of their importance but the students must read and treat Wage Boards and pay commission as a part of wage fixation.

10.3.5 Role of Wage Board

According to the Chamber Encyclopedia, the term 'Wage Board' covers,

- A voluntary negotiating body set up by discussions between organized employers and workers to regulate wages, working hours and related conditions of employment by collective bargaining.
- A body set up by law or with legal authority to establish minimum wages and other standards of employment which are then legally enforceable in the particular trade or industry to which the Board's decision relate.

The Committee on Fair Wages was the first to propound the idea of a Wage Boards; this was followed by the support of First Five Year Plan. The Second Five Year Plan also considered the Wage Boards to be 'a more acceptable machinery for settling wage disputes, a machinery which gives the parties themselves a more responsible role in reaching decisions.'

The Wage Boards appointed in India are of two types, namely:

(i) Statutory Wage Boards, appointed under some statute, example the Bombay Industrial Relations Act, the C.P. & Berar Industrial Disputes Settlement Act, the Working Journalists (Conditions of Service) and Miscellaneous Provisions Act, 1955.

(ii) Tripartite Wage Boards, which are not appointed under any statute but are appointed in pursuance to the recommendations contained in the Second Five Year Plan. These tripartite wage boards being non-statutory, the binding force of their recommendations depends on the acceptance of the recommendations by the parties.

Following are the matters which are referred to the Wage Board for decision:

- Reduction intended to be of permanent or semi-permanent character in the number of persons employed or to be employed in any occupation, or processes or departments or in shift not due to *force majeure*
- Permanent or semi-permanent increase in the number of persons employed or to be employed in any occupation or processes of department or departments.
- Rationalization or other efficiency systems of work
- Wages including period and mode of payment
- Hours of work and rest intervals

When a matter is referred to a Wage Boards, no proceedings may be commenced or continued before Conciliator, Conciliation Board, Labour Court or Industrial Court. It is obligatory for the government to declare the decisions of the Wage Boards binding, but where it feels that it will be inexpedient on public grounds to give effect to the whole or any part of the decision, the matter has to be placed before the State Legislature, the decision of which will be binding. There is provision for filing of appeals from the decisions of the wage boards to the Industrial

Court. Wage Boards derive their jurisdiction from the terms of references. The powers and procedures of the Wage Boards are the same as those of Industrial Tribunals constituted under the Industrial Disputes Act 1947 and those of Industrial Courts constituted under the Bombay Industrial Relations Act. The Wage Boards are not courts in the strict sense of the term and the functions which they perform are quasi-judicial in character.

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Since its inception in 1957, wage boards have been appointed for the following industries:

Cotton textiles, Sugar, Cement, Jute, Tea Plantation, Rubber Plantation, Coffee Plantation, Iron and Steel, Iron Ore Mines, Coal Mines, Limestone and Dolomite Mines, Working Journalists, Non Working Journalists, Ports and Docks, Engineering, Heavy Chemicals and Fertilizers, Leather and Leather Goods, Electric Undertakings, Road and Transport.

Wage Boards are constituted by the government and the boards have equal number of representatives of employers and workers. The board has an independent Chairman and to assist the functioning of the board, an economist and a consumer representative are nominated to the board. While considering the issues of wage fixation, the board along with the terms of reference also considers:

- The needs of industry in a developing economy
- The requirements of social justice
- The need for adjusting wage differentials in such a manner as to provide incentives to workers for advancing their skill.

Since their inception the wage boards have acted as a forum for collective bargaining and have evolved as an important wage fixing mechanism. It has succeeded to an extent in promoting negotiation as a method for settling wage fixation issues. But wage boards have been subject to criticisms such as, narrow interpretation of terms of reference, delay in submission of reports, lack of appreciation of impact which their awards would have on the economy as a whole.

Criticism of Wage Board

Although Wage Boards have been playing a critical role in wage fixation, critics have found the following shortcomings in the working and role of Wage Boards:

- The most significant criticism leveled at the role played by the Wage Boards is that of its lack of suitability. In other words, critics have found that having a single mechanism in form of Wage Boards for fixing wages for all types of industries, irrespective of its nature, unsuitable. They believe that wage fixation should be based on the nature of the industry and along with wage boards other mechanisms like collective bargaining and adjudication must also be encouraged.
- Another criticism aimed at wage boards is that their recommendations are neither unanimous nor based on consensus. Further, the critics point out

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that most of the boards' recommendations remains un-implemented, thereby questioning the very role of wage boards in India.

- One universally accepted principle of compensation is its direct association with productivity. But it seems that, as critics say, the board has missed a point by not considering seriously the issue of linking wage with productivity.
- Further, the procedural delays involved in the working of wage boards has also made critics call into question the very nature of Wage Boards functioning.

10.3.6 Pay Commissions

In India, the compensation plans for the Government servants are determined and fixed by the Pay Commissions. Till date Seven Pay Commissions have been appointed and their recommendations have been implemented. Pay Commissions are responsible for recommending and fixing the pay scales of Government employees. In fixing pay scales the Commission does not follow any one single principle, in fact it takes into account the following principles:

- **Equal pay for equal work:** This is the most important principle considered by the Commission as it is enshrined as a right in the Constitution of India.
- **Parity with outside employment:** The pay scales of the government servants should be fairly comparable to the pay scales in the private sector. In other words, the government employees should be paid at a rate which corresponds to the comparable situation in outside employment. The British Industrial Court in its 1935 award supported this principle while dealing with the wages of postal employees.
- **Cost of living:** The salaries paid to government employees must be adequate and fair. It should be linked to the cost of living, but in India this cost varies from region to region. Hence while fixing the pay scales; the Commission must consider the regional variations. Further, the pay scales should be revised and adjusted to the changes in the cost of living.
- **Economic position of the country:** The compensation plan of the government for its employees should bear relationship with the per capita income of the country. This is to link the compensation plan with the financial position of the government.
- **State as a model employer:** Another principle which should be considered while determining pay scales of government employees is that the state should act as a model employer. The term 'model employer' means:
  - (i) An employer who is ahead of other employers in the society in matters of pay and other conditions of service.
  - (ii) The state should be one of the front rank employers in the society; it need not march ahead of them.
  - (iii) It only emphasizes the responsibility of the state towards its employees and nothing beyond that.

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- **Other principles:**
  - (i) Social considerations, that is, the disparities between the highest and the lowest salaries should be the least.
  - (ii) Wage and Salary legislations
  - (iii) Hazardous nature of the job
  - (iv) Reasonable demands of employee unions are also considered.

Recently the Government of India has accepted the recommendations of the Seventh Pay Commission and has started the process of implementing it.

Check Your Progress

3. Why were the Minimum Wages Act, 1948 and Committee on Fair Wages in 1949 constituted?
4. When was the Industrial Truce Resolution adopted?
5. What are the main areas of concern of unions with respect to wages?
6. Where do the wage boards derive their jurisdiction and powers from?

10.4 PERFORMANCE PARAMETERS AND BENEFITS

You have already learnt about the concept of performance parameters in the previous unit. There you were introduced to the concept of performance linked payements. To recapitulate, performance parameters are indicators like, quality, teamwork, flexibility, ability, etc. The performance parameters differ not only among job roles but also among companies. Each company and the administration might decide their own parameters for judging employee performance. Some of the broad performance parameters may be employee effficiency, quality of work, performance in training, business turnover, employee attendence, target achievements, interaction with team members, deadline adherance, individual goals of the employees among other factors.

Based on the performance parameters, employees must also be rewarded through benefits. This helps in recognizing their efforts and dedication to work and to the organization, boosting their morale, motivating them to remain loyal and engaged to the organization and helps them feel appreciated. Let's discuss some of the types of benefits which employees may be given as a part of their compensation.

Service Benefits

Service benefits represents the amount of pension benefit accrued by an employee who actively worked during a given time period. Apart from pension, there are many other service benefits like post-employment life insurance and medical care as well as gratuity and other retirement benefits.

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10.4.1 Merit cum Rewards: Token of Gifts and Citation

Merit means an individual efficiency, capacity and stability to be judged as past work performance of any company or organization. It can be defined any educational qualification or any talented performance experiences of an individual person.

Every employee should get their rewards according to their merit or ability of their performance. There may be either monetary rewards or non-monetary benefits. It basically depend upon their talent and capacity of their job stability of previous job satisfaction and performance of the employees in the organization.

Token of Gifts

Small tokens of gifts or appreciation for an outstanding job performance can be a more powerful or boost their staff as motivator than expensive benefits of the organization. Small gifts can be more visible. They can send a clear message to staff that they are valued and create a buzz in the workplace. Such gifts can include a bunch of flowers, champagne, a voucher for a meal for two, or chocolates. To maximise the gifts' effectiveness, employers should tailor them to suit the profile of their workforce.

- **Powerful psychological effect:** David Tong, a senior consultant at Mercer, says: 'Small gifts have a powerful psychological effect. This effect can be disproportionate to their value when they are viewed by the recipient as recognition of a job well done or a special effort made. Sometimes employees are happy with a word of thanks and do not feel a small gift is necessary. However, the act of giving is a strong, almost ceremonial way to provide recognition to employees.'

  Gifts, then, are about sending a clear message to staff that their employer appreciates them. Neil Conway, senior lecturer in organizational psychology at Birkbeck University, says: 'Small gifts in the short term may boost an individual's mood or morale. Gifts may also have a longer-term effect by making the recipient feel valued by their employer. In other words, they are symbolic of being party to a caring relationship.'
- **Single out individuals:** The best strategy is to single out individual employees, says Carolyn Axtell, senior lecturer at Sheffield University's Institute of Work Psychology. 'All staff get bonuses and a pension, based on an organization's performance rather than the individual's,' she says. 'To be singled out for praise or to be given a gift that shows appreciation for particular actions is far more motivating because it shows individual efforts have been appreciated. This is more likely to motivate someone to repeat the same positive actions.'
- **Staff feedback is crucial:** So listening to staff feedback is crucial. Laura Meneaud, HR director at lingerie retailer Bravissimo, says: 'The biggest thing is to listen to employees. Ask them what would make them feel appreciated, valued and engaged. It is not always about gifts, but can be

about how they are managed, whether they feel listened to, and how they feel about their work-life balance.'

- **Darker side to giving:** There can also be a darker side to gift giving. For all the popularity of the small gift model, Birkbeck University's Conway has doubts about it. The division of gifts is highly emotive, he says. "Employees who do not receive a gift, but feel they are entitled, may feel inequity and favouritism takes place. Gifts mean a degree of spontaneity and stepping outside of custom, so are particularly prone to claims of unfairness."

Case study

- **Little things mean a lot at Bravissimo:** Lingerie retailer Bravissimo supports its staff with a host of small gifts, including shopping vouchers, cupcakes and jars of sweets. Laura Meneaud, HR director, says: "We like the little-and-often approach, rather than big, grand gestures. We feel it is important to value and appreciate our employees throughout the year. Recognition is timely and, where possible, tailored to the team or department. We also ask for feedback from our employees about the gifts." The company, which has 680 staff, also gives mini eggs at Easter and chocolate snowmen at Christmas. All workers receive birthday gifts chosen by colleagues. Then there are one-off gifts such as champagne or cinema tickets with popcorn after a busy period.

  "We generally look to recognise teams rather than individuals and are conscious it is the sum of the individuals that makes the difference," says Meneaud. "We think about the gifts and don't just spend money on them for the sake of it."
- **Madgex says a big thank you:** Recruitment software company Madgex shows its gratitude to employees with cakes and bottles of bubbly.

  At the firm, which has 54 staff, managers send out regular thank-you emails, copying in the whole company, so people can see who has worked particularly hard on a difficult project.

  Hanna Smith, HR director, says: "Saying thank-you little and often goes a long way. Employers can all too often overlook someone's hard work and commitment to the company. At Madgex, we truly do value and recognise that our employees go out of their way to do their job."

  As well as small gifts, employees get a pension scheme, bonuses linked to company performance, a cycle-to-work scheme, childcare vouchers and 25-30 days' holiday a year.
- **Metaswitch turns on the treats:** Communications technology firm Metaswitch rewards employees who go the extra mile with treats such as vouchers for meals for two. The company, which has 540 staff, gives newlyweds wine glasses and new parents bouquets of flowers. There are also bottles of champagne at long-service milestones. All new joiners receive a bag of Metaswitch goodies, comprising a branded sports bag, folder and pen.

Justine McLennan, personnel and recruitment manager, says: "We have learned that gestures of this sort can have a very positive effect on an individual or team. When combined with a hand on, collaborative management style and our suite

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of more expensive benefits, it creates an effective mechanism to make employees feel appreciated and rewarded."

McLennan says it is crucial to make sure gifts are dealt out fairly. "Provide clear guidance to managers so that the policy is applied equitably, and with sound and consistent judgement," she adds.

Citation

Citations are the official recognition or mention of excellence in performance by the employees. These can be in the form of letter, certificate or an award. Every company has a different way and nomenclature for varied levels of citations. These are given periodically to keep the morale of the employees high and to give a recognition to them in front of the team acknowledging their good work. The citations act as rewards for employees praising different traits like communication, dependability, judgement, team work, creativity, technical skills, problem solving and many more.

10.4.2 Promotion

Promotion is vertical movement of an employee within the organization. In other words, promotion refers to the upward movement of an employee from one job to another higher one, with increase in salary, status and responsibilities. Promotion may be temporary or permanent, depending upon the needs of the organization.

There can be also dry promotion, where an employee is assigned to a higher level job without increase in pay. For example of dry promotion is a University Professor made Head of the Department with no increase in salary.

Promotion has an in-built motivational value as it elevates the authority, power and status of an employee within an organization. It is considered good personnel policy to fill vacancies in a higher job through promotions from within because such promotions provide an inducement and motivation to the employees and also remove feelings of inactivity and frustration.

Types of Job Promotions

There are three types of promotion that classified in below as follows:

(i) **Horizontal promotion:** When an employee is shifted in the same category, it is called 'horizontal promotion'. A junior clerk promoted to senior clerk is such an example. It is important to note that such promotion may take place when an employee shifts within the same department, from one department to other or from one plant to another plant.

(ii) **Vertical Promotion:** This is the kind of promotion when an employee is promoted from a lower category to lower category involving increase in salary, status, authority and responsibility. Generally, promotion means 'vertical promotion'.

(iii) **Dry Promotion:** When promotion is made without increase in salary, it is called 'dry promotion'. For example, a lower level manager is promoted to

senior level manager without increase in salary or pay. Such promotion is made either there is resource/fund crunch in the organization or some employees hanker more for status or authority than money.

Promotion based on merit motivates competent employees to work hard while trade unions oppose it on the justification of its subjectivity. In India, generally, the promotion in the government departments is made on the basis of seniority of the employees. In case of private organizations, merit is generally used as a basis for promoting employees. Here, the promotion policy is to promote the best one available.

No single basis of promotion is acceptable and applicable to all organizations. Every basis has its strengths and weaknesses. For example, while promotion on the basis of seniority gives satisfaction to the senior employees, it causes frustration to the talented ones.

Purpose of the Promotion

There are several objectives of the job promotion of the employees in the organization as follows:

- To recognize an employee's skill and knowledge and utilize it to improve the organizational effectiveness.
- To reward and motivate employees to higher productivity.
- To develop competitive spirit and inculcate the zeal in the employees to acquire skill, knowledge etc.
- To promote employees satisfaction and boost their morale.
- To build loyalty among the employees toward organization.
- To promote good human relations.
- To increase sense of belongingness.
- To retain skilled and talented people.
- To attract trained, competent and hard working people.
- To impress the other employees that opportunities are available to them too if they also perform well.

Promotion is like a double-edged weapon. Hence, every organization needs to evolve and implement a suitable promotion policy for its employees. The following section deals with the same.

- It must provide equal opportunities for promotion across the jobs, departments, and regions.
- It must be applied uniformly to all employees irrespective of their background.
- It must be fair and impartial.
- The basis of promotion must be clearly specified and made known to the employees.

- It must be correlated with career planning. Both quick (bunching) and delayed promotions must be avoided as these ultimately adversely affect the organizational effectiveness.
- Appropriate authority must be entrusted with the task of making final decision.
- Promotion must be made on trial basis. The progress of the employee must be monitored. In case, the promoted employee does not make the required progress, provision must be there in the promotion policy to revert him/her to the former post.
- The policy must be good blending of promotions made from both inside and outside the organization.

According to Dale Yoder, 'Promotion provides incentive to initiative, enterprise and ambition, minimizes discontent and unrest; attracts capable individuals; necessitates logical training for advancement; and forms an effective reward for loyalty and cooperation, long service, etc.' Promotion benefits both employees and the employer.

However, it needs to be made with a great caution because wrong promotion may invite implications of one type or other for the organization.

Check Your Progress

7. Give some examples of token of gifts for employees.
8. Why do trade unions oppose promotion based on merit?
9. What is dry promotion?

10.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. In actual practice of wage determination, a number of factors such as the philosophy of management towards wages, region-cum-industry settlements, internal pricing through job evaluation employer's capacity to pay, court judgments, local area going rates, collective bargaining and government laws.
2. The primary objective of wage and salary administration program is that each employee should be equitably compensated for the services rendered by him to the enterprise on the basis of the nature of the job, the present worth of that type of job and the effectiveness with which the individual performs the job.
3. To implement the Statutory fixation of minimum wages in sweated industries, the Government passed the Minimum Wages Act in 1948, which researched on the same. And to implement the Promotion of fair wages agreement in more organized industries, the Government appointed a Committee on Fair Wages in 1949.

4. The beginning of wage policy in India can be traced to the Industrial Truce Resolution which was unanimously adopted in 1947.
5. With respect to wages, the unions are primarily concerned with:
    - General level of wages
    - Structure of wage rates
    - Bonus, incentives and fringe benefits
    - Administration of wages
6. Wage Boards derive their jurisdiction from the terms of references. The powers and procedures of the Wage Boards are the same as those of Industrial Tribunals constituted under the Industrial Disputes Act 1947 and those of Industrial Courts constituted under the Bombay Industrial Relations Act.
7. Token of gifts can send a clear message to staff that they are valued and create a buzz in the workplace. Such gifts can include a bunch of flowers, champagne, a voucher for a meal for two, or chocolates.
8. Promotion based on merit motivates competent employees to work hard while trade unions oppose it on the justification of its subjectivity.
9. When promotion is made without increase in salary, it is called 'dry promotion'.

10.6 SUMMARY

- A "Wage Determination" is the listing of wage rates and fringe benefit rates for each classification of labourers and mechanics.
- Wages can be expressed in two ways. When they are expressed in terms of money paid to the worker they are called **nominal wages**. But when they are expressed in terms of their purchasing power with reference to some base year they are called original **wages**. These wages are arrived at by making adjustment in the nominal wages for the rise or fall in the cost of living.
- The subsistence theory of wages or salary, states that the real wages of unskilled workers always remain at or very little above subsistence level. If real wages rise more than enough to provide a bare subsistence, the population would expand at a greater rate than the increase of food and other necessaries.
- According to the Marginal productivity theory of wages, in every enterprise there is a point beyond which it will not pay the management to engage more labourers. At this point the labourer produces just enough to cover his cost to the employer.

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- What then **determines the wages** of a worker? In actual practice it seems to be determined by a number of factors such as the philosophy of management towards wages, region-cum-industry settlements, internal pricing through job evaluation employer's capacity to pay, court judgments, local area going rates, collective bargaining and government laws.
- Determination of an equitable wage and salary structure is one of the most important phases of employer-employee relations. For good industrial relations, each employee should receive sufficient wages and salaries to sustain himself and his dependents and feel satisfied with a relationship between his wages and wages of other people performing the same type of work in some other organization.
- Wage determination has a recent history in India, and in fact, it was only as late as 1947, that under Industrial Disputes Act, various tribunals passed awards regulating wages in a number of industries.
- Institutions like collective bargaining, industrial wage boards, government appointed pay commissions, and adjudications by courts also exist in India.
- Bargaining is usually conducted through a union representing the workers and an association representing the interests of the industry of a particular area or a region. Through bargaining workers settle issues like wages, hours and conditions of employment, but it is usually wages which is the focus of the bargain.
- The Minimum Wages Act, 1948 provides for machinery for statutory fixation and revision of minimum wages in the scheduled employments, including plantations and agriculture. Though the Act provided for protection of the workers interest, it failed to provide any guidance in matter of content of a minimum wage, factors to be considered while fixing minimum wage, size of family unit for which minimum rates have to be fixed, weightage to be given to cost of living, etc.
- In India, judicial adjudication has emerged as an important tool for settling wage disputes, determining wage scales and for standardization of wages and allowances. The primary function of judiciary was to adjudicate in industrial disputes, but since the majority of disputes concerned wages, the judiciary has started playing an important role in wage fixation.
- According to the Chamber Encyclopedia, the term 'Wage Board' covers: (i) A voluntary negotiating body set up by discussions between organized employers and workers to regulate wages, working hours and related conditions of employment by collective bargaining and (ii) A body set up by law or with legal authority to establish minimum wages and other standards of employment which are then legally enforceable in the particular trade or industry to which the Board's decision relate.
- Wage Boards are constituted by the government and the boards have equal number of representatives of employers and workers. The board has an

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independent Chairman and to assist the functioning of the board, an economist and a consumer representative are nominated to the board.

- In India, the compensation plans for the Government servants are determined and fixed by the Pay Commissions. Till date Seven Pay Commissions have been appointed and their recommendations have been implemented. Pay Commissions are responsible for recommending and fixing the pay scales of Government employees.
- Performance parameters are indicators like, quality, teamwork, flexibility, ability, etc. The performance parameters differ not only among job roles but also among companies. Each company and the administration might decide their own parameters for judging employee performance. Some of the broad performance parameters may be employee effficiency, quality of work, performance in training, business turnover, employee attendence, target achievements, interaction with team members, deadline adherance, individual goals of the employees among other factors.
- Merit means an individual efficiency, capacity and stability to be judged as past work performance of any company or organization. It can be defined any educational qualification or any talented performance experiences of an individual person.
- Small tokens of gifts or appreciation for an outstanding job performance can be a more powerful or boost their staff as motivator than expensive benefits of the organization. Small gifts can be more visible. They can send a clear message to staff that they are valued and create a buzz in the workplace. Such gifts can include a bunch of flowers, champagne, a voucher for a meal for two, or chocolates.
- Citations are the official recognition or mention of excellence in performance by the employees. These can be in the form of letter, certificate or an award. Every company has a different way and nomenclature for varied levels of citations.
- Promotion is vertical movement of an employee within the organization. In other words, promotion refers to the upward movement of an employee from one job to another higher one, with increase in salary, status and responsibilities. Promotion may be temporary or permanent, depending upon the needs of the organization.

10.7 KEY WORDS

- **Wage determination**: It is the listing of wage rates and fringe benefit rates for each classification of labourers and mechanics.
- **Collective bargaining:** The term 'relates to those arrangements under which wages and conditions of employment generally are decided by agreements negotiated between the parties.'

- **Pay commissions:** These are commissions constituted in India which are responsible for recommending and fixing the pay scales of government employees.
- **Promotion:** It refers to the upward movement of an employee from one job to another higher one, with increase in salary, status and responsibilities.

10.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. Write a short note on the definition of wage determination.
2. Briefly mention the importance of collective bargaining in wage determination.
3. What are token of gifts, citations and merit cum benefits?
4. Write a short note on the role of Pay Commissions and their principles.

Long Answer Questions

1. Explain the history of wage legilation in India.
2. Discuss the importance of statutory wage determination law and adjudication in India.
3. Describe the machinery of wage board and mention the criticism against it.
4. Explain the types of promotion.

10.9 FURTHER READINGS

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UNIT 11 PERFORMANCE COMPENSATION

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Structure

11.0 INTRODUCTION

Performance related pay or compensation is a salary, payment or wage system that is based on the position of the individual or team according to their work associated with their pay band. It is a financial reward system for employees, in which, some or all of their monetary compensation is associated with their performance or service criteria basis. Performance related pay can be used for a business purpose for an individual, a team, or the entire company that performs during a stipulated time format. Performance compensation systems provides financial compensation that focuses on individual, team or group performance. In this unit, this concept has been explained, along with its structure, related measures, key performance parameters and control of employee cost.

11.1 OBJECTIVES

After going through this unit, you will be able to:

- Understand the concept of performance compensation
- Describe the structure and measures related to performance compensation
- Discuss the key performance parameters and control of employee cost

11.2 CONCEPT OF PERFORMANCE COMPENSATION

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Performance compensation or performance-related pay system is used by several employers. It has become a standard system for evaluating employees and setting up their salaries. In fact, this method has been in use since centuries especially in sales, where commission is a performance based compensation, as their salary depends on how much they sell. In practical terms, salary is evaluated constantly on the basis of the performance of a single employee or a whole company. Basically, higher the performance, higher is the pay, while lower the performance, lower is the pay. On the other hand, the performance-based pay rise system is the form of reward through pay rise. In case of good performance, an individual or team gets a pay hike, while the poor performance is given no reward.

11.2.1 Pay Performance and Structure

Pay includes two different forms of compensation that is, direct and indirect compensation. Non-monetary pay can include any benefit an employee receives from an employer or job that does not involve tangible value. This includes career and social rewards, such as job security, flexible hours and opportunity for growth, praise and recognition, task enjoyment, and friendship.

Table 11.1 *Types of Non-Monetary Pay*

Non-Monetary Pay	Includes benefits that do not involve tangible value.
Direct pay	Employee's base wage.
Indirect pay	Everything from legally required programs to health insurance, retirement, housing, etc.
Basic pay	Cash wage paid to the employee. Since paying a wage is a standard practice, the competitive advantage can only come by paying a higher amount.
Incentive pay	A bonus paid when specified performance objectives are met. It can inspire employees to set and achieve a higher performance level and is an excellent motivator to accomplish goals.
Stock options	A right to buy a piece of the business that may be given to an employee as a reward for excellent service. An employee who owns a share of the business is far more likely to go the extra mile for the operation.
Bonuses	A gift given occasionally as a reward for an exceptional performance or for special occasions. Bonuses can show that an employer appreciates his or her employees and ensures that good performance or special events are rewarded.

Direct pay or compensation is an employee's base salary. It can be an annual salary, hourly salary, or any performance based payment that an employee receives, such as profit-sharing bonuses. On the other hand, Indirect pay or compensation is far more varied, including everything from legally required public protection programs such as social security to health insurance, retirement programs,

paid leave, child care, or housing to some that are required by law: social security, unemployment, and disability payments. Other indirect elements are up to the employer and can offer excellent ways to provide benefits to the employees and the employer as well. For example, a working parent may take a lower-paying job with flexible hours that will allow him or her to be home, when the children get home from school. A recent graduate may be looking for stable work and an affordable place to live. Both of these individuals have different needs and therefore, would appreciate different compensation elements.

11.2.2 Measures

Firms are increasingly presented financial and non-financial performance measures for their sub unit of their balance scorecard and their other perspectives are:-

- Financial
- Customer
- Internal business process
- learning growth

Firms assumed that the improvement in learning and growth will lead to improvement in internal business process. Improvement in internal business process leads to better financial and customer dealing procedure.

Accounting based performance measures

There are six steps for creating the required performance measuring perspectives:

(a) **Step 1:** Choose the performance objectives, which align with top management financial goals.

(b) **Step 2:** Choose the horizon time for each performance measure.

(c) **Step 3:** Choose the definition of the component of the performance measures.

(d) **Step 4:** Choose a measurement alternative for each performance measure.

(e) **Step 5:** Choose a target level performance.

(f) **Step 6:** Choose the timing of the feedback.

Different performance compensation measures

There are four main perspectives for choosing the different performance compensation measures for an economic performance:

I. **Return on Investment (ROI):** It is an accounting measure of income divided by an accounting measure of the investment. Return on Investment (ROI) is a performance measure used to evaluate the efficiency of an investment or compare the efficiency of a number of different investments. ROI tries to directly measure the amount of return on a particular investment, relative to the investment’s cost. To calculate ROI, the benefit (or return) of

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an investment is divided by the cost of the investment. The result is expressed as a percentage or a ratio. The formula of ROI is:

ROI = (Current Value of Investment - Cost of Investment) / Cost of Investment

In the above formula, 'Current Value of Investment' mentioned is obtained from the sale of the investment of the interest. ROI is measured as a percentage, that it can be easily compared with returns from other investments.

$$\text{ROI} = \frac{\text{Net Profit}}{\text{Cost of Investment}}$$

The most popular criterion are as follows:

- It blends all the interest of the profitability (revenue, cost, profit, investment) into single percentage.
- It can also be compared to other ROIs in both inside and outside of the firm.

It is also called Accounting rate of return (ARR) or Accrual accounting rate of return (AARR). ROI may decomposed into two components, which are as follows:

$$\text{ROI} = \frac{\text{Operating income} \times \text{Revenue}}{\text{Total assets} \times \text{Revenue}}$$

$$\text{or, ROI} = \frac{\text{Revenue}}{\text{Total assets}} \times \frac{\text{Operating income}}{\text{Revenue}}$$

$$\text{or, ROI} = \text{Investment turnover} \times \text{Return on sales}$$

This calculation method is known as Dupont method of profitability Analysis.

II. Residual Income: Residual income is an account of the measuring part of the income minus a dollar amount of the required amount of the accounting measure of interest. Residual income is also the amount of net income generated in excess of the minimum rate of return. It have been used in a number of contexts, including as a measurement of internal corporate performance whereby a company's management team evaluates the return generated relative to the company's minimum required return. Alternatively, in personal finance, residual income is the level of income that an individual has after the deduction of all personal debts and expenses have been paid. The formula of RI is:

RI = Income – (RRR × Investment), where RRR=Required rate of return

III. Economic Value Added (EVA): Economic value added (EVA) is a measure of a company's or firm's monetary performance that is based on the residual wealth calculated by deducting its cost of capital from its operating profit, which is adjusted for taxes on a cash basis. EVA can also

be expressed economically as it attempts to capture the true economic profit of a company. This measure was devised by management consulting firm Stern Value Management, originally incorporated as Stern Stewart & Co. EVA is a specific type of residual income calculation that has recently gained popularity. The calculation of the weighted-average cost of capital equals the after-tax average cost of all long-term funds that in utility. Weighted average cost of capital is calculated as:

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$$\text{Weighted average cost of capital} = \frac{\left(\text{After-tax cost of debt capital} \times \text{Market value of debt}\right) + \left(\text{Cost of equity capital} \times \text{Market value of equity}\right)}{\text{Market value of debt} + \text{Market value of equity}}$$

IV. Return on sale: Return on sale is simply an income that is divided by sale. Return on sales (ROS) is a ratio used to evaluate a company's operational efficiency. This measure provides insight into the profit that is being made per dollar or rupees of sales. The increase in ROS indicates that a company is growing more efficiently, while a decrease could signal imminent financial troubles. The formula of ROS is:

$$\text{Return on Sales} = \frac{\text{Operating Profit}}{\text{Net Sales}}$$

Check Your Progress

1. What are the two forms of compensation?
2. What is an incentive pay?
3. Give some examples of public protection programs provided as indirect pay.

11.3 KEY PERFORMANCE PARAMETER

A quality, usually quantified by a numerical value, which characterizes a particular aspect, capability, or attribute of a system is known as key performance parameter. Examples of performance parameters are a point count and mean time between failures. Key Performance Parameters (KPP) are key system capabilities that must be met in order for a system to meet its operational goals. The Capability development document (CDD) and Capability production document (CPD) identify the KPP(s) that contribute to the desired operational capability in a threshold and objective format. Each KPP is supported by operational analysis that takes into account technology maturity, fiscal constraints, and schedule before determining threshold and objective values. If an attribute is considered important but not critical to meeting system goals, it can be classified as a key system attribute (KSA).

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The starting value of a KPP or KSA is the minimum acceptable value considering cost, schedule, and technology. Performance below the threshold value is not operationally effective or suitable. A KPP also has an objective value that is the desired operational goal considering cost, schedule, and technology. Performance above the objective value does not justify additional expense. The difference between the threshold and objective values sets the trade space. All KPPs and KSAs are validated by the Joint Requirement Oversight Council (JROC). There are several advances in technology and the changes in systematic goals, which may also result in difference in the KPP and KSA threshold and objective values, which will have to be validated by the JROC again. The list of mandatory KPP that every system should have according to the JROC manual are as follows:

- System survivability
- Force protection
- Energy
- Sustainment

11.3.1 Key Performance Indicator

The profits are only one of the many factors affecting a company's balance sheet. Key performance indicators (KPI) refer to the values used to assess a business' success in reaching its goals. In the long run, tracking relevant KPIs can help you make important decisions about your company's growth and development. Here are seven of the most important KPIs to track as a small business owner:

I. **Cash flow forecast:** Cash flow forecasts let businesses assess whether their sales and margins are appropriate, and are consequently one of the most important KPIs for small businesses to track. To make your cash flow forecast, add the total cash your business has in savings to the projected cash value for the next four weeks, then subtract the projected cash out for the next four weeks. Savvy business owners perform regular cash flow forecasts so they can identify problems in the early stages and make any necessary adjustments. Along with helping businesses anticipate upcoming surpluses or shortages, a cash flow forecast is crucial for tax planning and upcoming loan.

II. **Gross profit margin as a percentage of sales:** No business can achieve success if it's paying out more to suppliers than it's netting in sales each month from customers. Gross profit margin as a percentage of sales is an expression of total profits as they compare to revenue. First, find your business' gross profit margin (GPM) by dividing your gross profit amount by your sales. Take that and multiply it by 100 and you will have your gross profit margin as a percentage. Next, to find out how much of your GPM makes up your overall sales, divide that value by your sales amount. Here's an equation for easier reference:

$$\boxed{(\text{Gross Profit/Sales} \times 100) / \text{Sales}}$$

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The benefit of tracking this KPI over time is that one can easily quantify how much money one is keeping against the amount paid out to suppliers. As businesses retain more money, gross profit margin increases. But a decrease in gross margin as a percentage of sales could indicate that a business is overspending on its supplies. Owners would need to reduce overhead costs or increase prices on goods and services to compensate.

III. **Funnel drop-off rate:** It assesses the number of visitors who abandon a conversion process—or sales funnel—prior to completion. For the uninitiated, imagine a sales funnel as an actual funnel pointed downward. The top of the funnel is the widest part of it and represents the entry point for a customer to first get acquainted with a company or product. There are conversion steps along the way, progressing from the top of the funnel to the very bottom of the funnel, where the customer exits—or is 'converted' into a sale. With this in mind, the funnel drop-off rate is the number of customers that leave the funnel prior to buying something.

To calculate funnel drop-off, start by finding the number of visits of a particular conversion step, then subtract the number of visits of the first step. Divide the new value by visits of the first conversion step. By identifying when prospective buyers abandon the conversion process, companies can identify problems and make necessary adjustments to boost sales. With so many small businesses relying on the internet as a sales tool, funnel drop-off rate has become one of the most crucial performance indicators.

IV. **Revenue growth rate:** It might be obvious, but the revenue growth refers to the rate at which a company's income or sales growth is increasing. To find revenue growth rate, begin with your business' total revenue for the current year. Next, divide current revenue by total revenue from the previous year to find the rate of growth. By calculating revenue growth rate regularly, one can assess whether growth is increasing, decreasing, or plateauing. Use it to make any necessary changes to stay profitable.

V. **Inventory turnover:** Inventory turnover measures the number of times inventory is sold or used in a given period of time and is valuable because it reveals a business' ability to move goods. Inventory turnover can be calculated by adding up the cost of sold inventory, then dividing that total by the value of the remaining at year's end. While it's only natural for businesses to pursue a high turnover rate, companies should be wary of achieving this goal by reducing prices in excess. Calculating your inventory turnover ratio can help measure and plan for adjustments in inventory as needed.

VI. **Accounts payable turnover:** A business can't keep its door open for long if it fails to pay suppliers. Accounts payable turnover is a measure of the rate at which your business pays for goods and services, revealing the amount of cash spent on suppliers in a given period. To find accounts payable turnover, add up the cost of total supplier purchases and divide by average accounts payable. Once you know how much you spend on suppliers, you

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can determine if steps are needed to reduce spending, which should boost long-term profits for your business.

VII. Relative market share: One of the most crucial performance indicators, relative market sharing shows that how much of a given market is controlled by your business as a percentage. After finding your own market share, subtract this value from 100 to find the percent of the market controlled by other businesses. Then divide your market share by the percentage of the market not controlled. By multiplying the result by 100, a company can find its relative market share.

Unlike internal metrics, relative market share reveals how a company is performing relative to its competitors in the same space. After all, a small bump in profits may matter less if your company is falling behind its competitors. Once you calculate your relative market share, you can make strategic adjustments to your product and service offerings to improve long-term profitability for your business.

Check Your Progress

4. What is KSA?
5. What is responsible for setting the trade space?

11.4 CONTROL OF EMPLOYEE COSTS

Salaries and wages are one of the largest costs of every company and are often the most difficult to control. But changing compensation is touchy for those who are affected, so it is important to handle the changes with compassion, truth, and firmness. There is one way to identify the key of employees and get their commitment to the plans before implementing them. Companies that reduce compensation or fire employees without considering other methods to increase productivity or reduce costs invariably suffer from poor morale, indifferent customer relations, and further declines in sales, potentially falling into a downward spiral from which there is no recovery.

At the same time, although organizations understand the need to expand benefit offerings, there is also a growing concern about the affordability of doing so. Successful talent management costs money. According to the US Bureau of labor statistics, insurance benefits comprise the largest non-wage labor expense for US employers. Moreover, there are other labor costs like paid leave, investments in employee retirement and savings, and legally-mandated benefits costs. Most employers currently offer employees at least one type of insurance plan. However, even the cost of offering a modest level of benefits continues to rise at a level faster than the rate of inflation and the overall pace of economic expansion. According to the research conducted by the Office of the Actuary in the Centers for Medicare and Medicaid Services, aggregate US healthcare spending is estimated to increase

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5.6% annually through 2025 and this rate of increase is expected to outpace projected GDP growth by 1.2 percentage points. The cost of employee benefits is increasing at an alarming rate. The following tips will lead a company through a difficult process to ensure that the company is positioned to survive and thrive in any economic environment:

a) **Review levels of compensation:** Salaries and wages tend to move one way that is, upward, even though markets and financial conditions change. Review your pay schedules to be sure that they are in line with current trends and not the result of the history. If current employees are earning more than what should be paid for their jobs today, delay or make only token raises until such time that your payroll comes in line with current trends.

   Have a frank talk with the employees affected, so that they know what to expect and why their expected raises will not happen as in the past. You might also suggest ways they can become more valuable to the company by adding skills to earn future raises.

b) **Reduce employee turnover:** If a company has significant turnover, then it will incur excess costs due to the fees and salaries of people who are engaged in the recruitment, selection, employment, and training of new employees. The indirect and invisible costs are poor quality, longer production times, greater waste, greater oversight, and even fraud, since the employees view their time with the company as temporary. Maintaining a stable employee core is the key to effective cost-cutting.

c) **Cross-Train employees:** Specialist workers, with a unique skill set or license, generally command premium pay in the marketplace. But they also inhibit your ability to make changes in your operation if you are dependent upon their skills. A workforce trained to perform a variety of operations will enable you to make changes, including lay-offs, without affecting your ability to deliver products or services to your customers.

d) **Trade time off for payroll expense:** Some companies have cut costs by changing their hours of operations. For example, going to a four-day, 10-hour per day work week from a standard five-day, eight-hour workday in return for a lower salary or wage may be welcomed by employees, who seek more time with families or on personal projects.

e) **Share jobs between employees:** Office jobs are especially suited for sharing duties. Replacing full-time employees with part-time workers can reduce your administrative costs without necessarily reducing the hours for which the full-time employee was available. In most communities, there are a number of skilled people limited to working part-time. Utilize this resource when your need is less than a full work week or share a full-time job between two part-time employees.

f) **Convert fixed salaries and wages into commissions or fees:** By terminating employees, try converting their costs into an expense that is only paid, when there is accompanying revenue. For example, a salaried salesman may be willing to accept a higher commission rate and less guarantee or an installer might accept work as a contract laborer when work is available.

g) **Reduce perquisites:** Reduce the perquisites by converting pension plans into profit-sharing plans. Reduce the cost of health insurance with higher deductibles and employees paying a higher share of the premium costs. Eliminate the perquisites that began and grew during better times, including those you take as an owner.

h) **Eliminate redundancy between departments:** As companies grow, they often evolve into a group of independent departments, effectively eliminating inter-departmental communications and flow. In many cases, the same task is repeated in several departments. Periodically review your processes– handling orders, collecting funds, and directing installations to ensure minimal redundancy between separate functions.

i) **Automatize and outsource non-critical tasks:** Technology, specifically computer software, has improved enormously in recent years; it can handle more duties, it's user-friendly and inexpensive. Leverage your existing employees by using the most up-to-date tools to simplify and speed up their work. Consider outsourcing the specialized needs to third parties, especially if the utility of those services is occasional and non-critical. Rather than maintaining a licensed engineer or a certified public accountant, for example, it can utilize a less expensive clerk and outsource oversight to an independent firm for less cost than the full salaries of the specialists. Before taking such actions, however, be sure that the task performed will not affect the quality of your product, the ability to deliver products, or your ability to oversee the complete operation.

j) **Work overtime before hiring new employees:** Before hiring new employees, consider whether your current employees can do the work if they are available. If so, try to expand your delivery deadlines and/or add overtime. Most employees enjoy the extra pay. Compare the costs of overtime pay with the full costs of attracting, evaluating, hiring, and retaining new employees. At some point, if the high demand continues, you will be able to hire new people, secure in the knowledge that their job will continue.

k) **Consult an attorney before reducing the workforce:** If you are determined to reduce head count, first visit an attorney to be sure you comply with all the laws and regulations regarding terminations. It is never easy to lay off a faithful employee, but failure to take appropriate measures puts all of your employees at risk of losing their jobs permanently.

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Input together a financial package for the employee to be laid off, or otherwise help them survive unemployment. You might, for example, continue healthcare coverage for a time or contribute to a retraining program. And though you're concerned with the well-being of those you lay off, don't forget to protect yourself. The last place you want to end up is in the courthouse for a wrongful termination suit.

Results

Cutting significant costs in a company is akin to squeezing a balloon: As you pressure one area, another gets stretched. As a consequence, you must be attentive to unexpected consequences and be diligent in your implementation. Communications with employees prior to beginning a cost reduction campaign, with frequent updates, is critical to avoid wild speculations and destructive rumors among the staff. Inform them regarding the reason for the change in policies and what you hope to achieve as a result of the change, and encourage their participation and ideas in the exercise. Being involved, rather than being a victim, will maintain their commitment to the company and solidify your role as a leader, not a bean counter.

11.4.1 Implication and Problems

Every small-business owner has to balance the need to maintain adequate internal controls with budgetary constraints. An effective internal control system is vital to meet the long term business goals. The cost implications of some controls makes them unwise to include in the system. It is important to contemplate the costs of implementing internal controls against their potential and their direct and indirect benefits, when creating and implementing a small-business internal control system.

Direct cost implications

The most obvious direct cost implications is the effect on annual budget. Direct costs, such as hiring additional employees to achieve adequate separation of duties or automating business systems to increase information security, are sometimes too expensive for the budget to handle. As a result, small-business owners must substitute less costly and less effective controls and make allowances to increase their effectiveness. For example, they can conduct surprise internal audits and create clear, specific information security, and storage procedures.

Indirect cost implications

Indirect costs associated with implementing internal controls can affect efficient operations and productivity. For example, manual cash management controls including transaction verification, payment authorization, and account reconciliation procedures, may decrease efficiency so much that your employees find work-around to outwit manual controls. For these reasons, it's important to include indirect cost implications in deciding how to design and implement an internal control system.

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Direct versus indirect cost implications

In some cases, direct financial cost implications make it seem like implementing some internal controls isn't possible. It is important to consider the potential indirect costs associated with disregarding or implementing less effective controls. After conducting a thorough cost-benefit analysis, you might wonder whether you can afford not to implement strong internal controls. When it comes to designing and implementing strong internal controls, the cost implications of non-compliance with federal and state regulations, or the cost to repair a damaged reputation, often make investing in preventive controls a significantly better option.

Check Your Progress

6. What is the largest non-wage labor expense for US employers according to the US Bureau of labor statistics?
7. What happen in those companies that reduce compensation or fire employees without considering other methods to increase productivity?
8. What is the most obvious direct cost implication?

11.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The two forms of compensation are direct and indirect compensation.
2. An incentive pay is a bonus paid when specified performance objectives are met. It can inspire employees to set and achieve a higher performance level and is an excellent motivator to accomplish goals.
3. Some examples of public protection programs provided as indirect pay are social security to health insurance, retirement programs, paid leave, child care, or housing.
4. If an attribute is considered important but not critical to meeting system goals, it can be classified as a key system attribute (KSA).
5. The difference between the threshold and objective values is responsible for setting the trade space.
6. The largest non-wage labor expense for US employers according to the US Bureau of labor statistics is the insurance benefit.
7. In those companies that reduce compensation or fire employees without considering other methods to increase productivity or reduce costs invariably suffer from poor morale, indifferent customer relations, and further declines in sales, potentially falling into a downward spiral from which there is no recovery.
8. The most obvious direct cost implication is the effect on annual budget.

11.6 SUMMARY

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- Performance related pay or compensation is a salary, payment or wage system that is based on the position of the individual or team according to their work associated with their pay band.
- Performance compensation or performance-related pay system is used by several employers. It has become a standard system for evaluating employees and setting up their salaries.
- Pay includes two different forms of compensation that is, direct and indirect compensation. Direct pay or compensation is an employee’s base salary. Indirect pay or compensation is far more varied, including everything from legally required public protection programs to some that are required by law.
- A quality, usually quantified by a numerical value, which characterizes a particular aspect, capability, or attribute of a system is known as key performance parameter. Examples of performance parameters are a point count and mean time between failures.
- Salaries and wages are one of the largest costs of every company and are often the most difficult to control. But changing compensation is touchy for those who are affected, so it is important to handle the changes with compassion, truth, and firmness.
- Every small-business owner has to balance the need to maintain adequate internal controls with budgetary constraints. An effective internal control system is vital to meet the long term business goals.

11.7 KEY WORDS

- **Perquisites:** It is a benefit which one enjoys or is entitled to on account of one’s job or position.
- **Payroll:** It is the total amount of money that a company pays to its employees or a company’s records of its employees’ salaries and wages, bonuses, and withheld taxes.

11.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. What are the six steps involved in creating the required performance measuring perspectives?
2. Write a short note on key performance parameters.
3. Why is controlling employee costs important?

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Long Answer Questions

1. Explain the four main perspectives for choosing the different performance compensation measures for an economic performance.
2. Discuss the most important KPIs to track as a small business owner.
3. Prepare a list of tips which can help a company to survive in any economic environment.

11.9 FURTHER READINGS

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BLOCK - IV
CURRENT TRENDS IN WAGE INCENTIVES AND COMPENSATION

UNIT 12 LEGISLATIONS REGARDING COMPENSATIONS

Structure

12.0 INTRODUCTION

In this unit, you will be introduced to the legal aspects of wage fixation. When we say legal, we refer to the Constitutional directions and the guidelines established by legislative enactments for the fixing of wages. We shall list the three most important pieces of legislations, namely, the Payment of Wages Act, Minimum Wages Act, and the Payment of Bonus Act. These are three primary acts which work as a legal backdrop for all wage fixing issues.

12.1 OBJECTIVES

After going through this unit, you will be able to:

- Interpret the legislations regarding compensation
- Describe the key provisions of the Payment of Wages Act, Minimum Wages Act and the Payment of Bonus Act

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12.2 KEY PROVISIONS OF IMPORTANT ACTS

Some of the important legislative enactments, which form the basis for wage determination in India are discussed in the following sections.

12.2.1 The Minimum Wages Act, 1948

The Minimum Wages Act, 1948 is a piece of social legislation which aims at extending the principle of social justice that is enshrined in our Constitution to the workers of India. The Act seeks to provide protection to workers in employment where they are open to exploitation by unscrupulous employers.

Main provisions of the Act

All industries and employments do not fall under the purview of this Act. Establishments that fall under the purview of the Act are listed in a separate Schedule and are appended to the Act. It covers an establishment regardless of the number of workers actually employed.

Some of the employments listed in the schedule are:

- Employment in the woollen carpet making or shawl weaving establishments
- Employment in rice mill, flour mill or Dal mill
- Employment in tobacco manufacturing establishments
- Employment in any plantation or estate that is maintained for the purpose of growing cinchona, rubber, tea or coffee
- Employment in oil mills
- Employment under any local authority
- Employment on the construction or maintenance of roads or in building operations
- Employment in lac manufacturing units
- Employment in mica works
- Employment in tanneries and leather manufacturing units

Part II of the Schedule covers employment in agriculture. This includes the cultivation and tillage of the soil, horticulture, dairy farming, and the raising of livestock, bees or poultry. The minimum wages for agricultural workers are fixed both by the central and state governments/union territories. The appropriate government can add to the schedule any other employment in respect of which it is of the opinion that a minimum rates of wages should be fixed.

The Act contains a number of definitions, the most important among which is the definition of wages. 'Wages' stand for all the remuneration that is capable of

being expressed in terms of money which would, if the terms of the contract of employment, express or implied, were fulfilled, be payable to a person employed in respect of his employment or of work done in such employment. This includes salary, house rent allowance, dearness allowance, etc. but does not include the following:

- Any house accommodation, supply of light, water, medical attendance
- Any other amenity or any service excluded by general or specific order of the appropriate government
- Any contribution paid by the employer to a pension fund or provident fund or any other scheme of social insurance
- Any travelling allowance or travelling concession
- Any sum paid to the person employed to defray special expenses entailed on him by the nature of his employment
- Any gratuity payable on discharge

The Act makes it obligatory for the employer to pay the employees the minimum wage rate that has been notified by the government. The employer cannot pay anything less than the notified minimum wages. To keep up with the rising costs of living, the Act enables the government to revise the minimum rates of wages regularly, at the interval of every five years if possible. The Act limits the appropriate government from fixing minimum rates of wages in a scheduled employment that has less than 100 employees throughout the State.

The appropriate government can fix the minimum rates of wages for:

- Different employments
- Different classes in the same employment
- Adolescents, children and apprentices
- Different localities

The Act enables the appropriate government to fix the minimum rates of wages on an hourly, daily, monthly or annual basis as deemed fit by the government. The minimum rates of wages, as fixed by the appropriate government, may constitute the basic rate of wages, cost of living allowance, and the cash value of concessions in respect to the supply of essential commodities at concessional rates.

The rates of wages fixed by the government may be:

- A time rate
- A piece rate
- A guaranteed time rate
- An overtime rate

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With respect to fixing or revising of the minimum rates of wages, the Act directs the appropriate government to either:

- Constitute and appoint as many committees and sub-committees as it deems necessary for conducting enquiry into the matters of wage fixation. The committees and sub-committees must also advise the government on matters of wage fixation or revision.
- Notifying the proposals in the official gazette or informing the affected individuals by publishing the proposals. The notification must specify the date on which the proposals would be considered. The date should not be less than two months from the notification date.

For coordinating the work of different committees and sub committees, the Act empowers the state government to constitute advisory boards. The advisory boards are also allowed to tender advice in matters of minimum wage fixation. In a similar vein, the Act empowers the Central government to constitute a central advisory body to advise the Central and state government and coordinate the work of the advisory boards. Thus, constituted advisory bodies comprises of an equal number of employers' and employees' representatives, and of independent advisors not exceeding one-third of their total strength. According to the Act, the non-official members have a tenure of two years while others hold office at the pleasure of the government.

The Act provides for the cash payment of the minimum rates of wages. At the same time, the Act does not prohibit the payment of minimum wages in kind, if the appropriate government deems it necessary. The Act empowers the government to direct the supply of essential commodities at concessional rates by notifying it in the official gazette. The Act, further allows the authorized deductions from the fixed wages. With respect to scheduled employments, the Act allows the appropriate government to fix the number of working hours and rest days, and overtime payment. The Act also provides for the appropriate maintenance of registers and records.

The Act allows the authorities to hear wage disputes concerning non-payment of the fixed minimum rate of wages and other wage related issues and decide upon them. For the authorities to act accordingly, an application must be presented to the authority within six months of the cause of action. A delay in this procedure may be condoned if the failure to submit the application was caused due to sufficiently valid reasons.

The Act lays down the penalties for the violation of the provisions of the Act. If an employer (a) pays the employee less than the minimum rates of wages fixed for that employee's class of work; or (b) contravenes any rule or order made by the appropriate government under Section 13 regarding the hours of work, he would be punished with imprisonment up to six months or with fine up to 1000 or with both.

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Since the Act authorizes certain authorities constituted under its provisions to hear and decide claims, it prohibits the civil courts from entertaining claims arising out of non-payment of minimum wages. If an employee enters into a contract or agreement whereby he has to relinquish the rights bestowed upon him by the provisions of the Act then that particular contract is declared to be null or void as per the terms of the Act. However, the Act does not prohibit an employee from entering into a contract or an agreement if it is more beneficial to him. The Act considers the Central government to be the appropriate authority for enforcing the provisions of the Act with respect to the scheduled employment carried on by or under the authority of the Central government. This includes the railway administration, mines, oil fields, major ports or any corporation established by a Central Act. The Act holds the Chief Labour Commissioner responsible for implementing the provisions of the Act in the central sphere.

Within the ambit of State, the Act holds the officers of the industrial relations machinery responsible for the implementation of the Act and other labour laws as well. The states made provisions for the appointment of whole time inspectors, who were entrusted with the responsibility of implementing the Act. But some states instead of appointing new officials authorized the officials of revenue department, panchayat department and agricultural department to function as inspectors for the purposes of the Act.

12.2.2 The Payment of Bonus Act, 1965

Bonus in India was originally perceived as gratuitous payment made by an employer to his employee. But now the perception of bonus has changed and it is widely regarded as 'a deferred wage payable to employees which may be claimed by them as of right under the terms of employment.' Unlike the traditional view where bonus was perceived as charity of the employers, the modern worker sees it as a rightful share in the profits of the company. The claim for a bonus is based on two main considerations, namely:

- That there is a gap between the present wage and the living wage which the bonus can be expected to shorten to some extent
- That there is an available surplus or profits at the end of the year out of which bonus may be paid

The main objective of the Payment of Bonus Act, 1965 was to assuage the workers in order to maintain harmony between the labour and capital by allowing the employees a share in the prosperity of the firm.

Main features of the Act

All factories and establishments having twenty or more employees on any given day during an accounting year falls within the purview of the Act. Such factories and establishments remain under the jurisdiction of the Act, even when the number of employees falls below twenty. The Act also covers departments, undertakings and branches.

Following establishments are not covered by the provisions of the Act:

- Newly set up units or branches of existing establishments for six years from the date of its starting production. An exception is made if the unit or branch starts making profits from inception itself.
- Government institutions
- Reserve Bank of India
- Deposit Insurance Corporation
- Industrial Development Bank of India
- Agricultural Refinance Corporations
- Unit Trust of India
- Industrial Finance Corporations
- State financial corporations
- Employees of insurance companies and the Life Insurance Corporations
- Seamen
- Stevedore labour
- Universities and other educational institutions
- Hospitals, chambers of commerce and social welfare institutions
- Inland water transport
- Employees employed through contractors on building operation

Definition of 'employee' includes any person (other than an apprentice) employed on a salary or wage not exceeding ` 3,500 per month in any industry to do any skilled or unskilled, manual, supervisory, managerial, administrative, technical, or clerical work for hire or reward. The term employment may be expressed or implied. There must, however, be a contract of service between the person employed and the employer.

The accounting year

- For a corporation, accounting year refers to the year that ends on the day on which the books and accounts of the corporation are to be closed and balanced.
- For a company, accounting year refers to the period for which profit and loss accounts are presented before the annual general body meeting.

The term 'salary' or 'wage' includes basic pay and dearness allowance. It does not include any other allowance. It also excludes the value of house accommodation, supply of electricity and water, medical attendance or amenity. Concessional supply of food grains or other articles, travelling concessions, contributions to pension or provident funds, retrenchment compensation, gratuity, etc. are also not parts of 'salary' or 'wage'.

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In case of establishments which have several departments or branches in similar or different locations, one bonus is calculated for all the establishments. If the branches or departments maintain a separate balance sheet or profit and loss account then these departments or branches will be treated as separate entities having their own bonus liabilities.

Determination of gross profit is the first step towards calculating the amount of bonus. The gross profits in the case of a banking company may be calculated in the manner specified in the First Schedule, or, in any other case, as specified in the Second Schedule. From gross profit, certain prior charges like remuneration to partners or proprietors, a return of 8.5 per cent on equity capital and 6 per cent in reserves, depreciation under the Income Tax Act, development rebate or investment allowance, direct taxes and dividends paid out of the allocable surplus are to be deducted. In case of a company, the allocable surplus is 67 per cent of the available surplus and in other cases it is 60 per cent of the available surplus.

According to the Act, every employee who has worked in the establishment for not less than thirty working days in that year is entitled for a bonus for that accounting year. The Act also explicitly mentions the clauses which disqualifies an employee form receiving the bonus. An employee is not entitled for a bonus if he is dismissed from the service on following grounds:

- Misappropriation of funds or attempting to defraud the establishment
- Indulging in unruly and inappropriate behaviour within the establishment premises
- Stealing or damaging property belonging to the establishment

The Bonus Act makes it obligatory for the employer to make a bonus payment of ₹ 100 or 8.33 per cent of the total salary depending on whichever is the higher amount. The bonus payment has to be made every accounting year, irrespective of the profit or loss incurred during that financial year. In case the salary or wage of an employee crosses ₹2,500 per month, the bonus paid will be calculated on the assumption that the employee in question draws a salary or wage of ₹ 2,500. In situations where the employee has been absent from work on all working days in a financial year, the Act provides for proportionate reductions in the bonus. The Act provides for carrying over of the excessive allocable surplus, which remains after the distribution of maximum bonus to the employees. Such surplus will be set-on and taken into account while computing the bonus for the next financial year. On the other hand, if the establishment faces shortage of allocable surplus, the computed bonus will be carried forward for set-off in the next financial year. The Fourth Schedule of the Act describes the method for carrying over the surplus or the deficit in allocable surplus.

The Act exempts newly established factories and establishments from making bonus payments for a period of six years following the accounting year in which it starts production. Alternatively, the Act exempts bonus payments up to the financial

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year when profits start to accrue. The Act allows for adjustments in customary or puja bonus payments against the bonus payable under the Act.

The Act allows the employer to recover the financial loss caused by an employee by deducting the amount from the bonus amount payable to the latter. But this clause is applicable only if the employee is proven guilty of the misconduct. The time frame allocated to the employers for the disbursement of bonus is eight months from the close of the accounting year. If there is a dispute, the bonus is to be paid within one month from the date on which the award becomes enforceable. But the appropriate government is well within its right to extend the said period up to a maximum of two years. The Act allows the employee or any person authorized by him in writing to approach the appropriate authority for the recovery of the due bonus amount under a settlement, award or agreement. In case of the employee's death, his heir or his assignee is allowed to approach the appropriate authority for the recovery of the due bonus amount under a settlement, award or agreement. If the claims are found to be valid, the government may then direct the Collector to recover the due amount.

Bonus disputes arising under the provisions of the Bonus Act are deemed industrial disputes. Therefore, bonus disputes can be raised by the employees only in accordance with the provisions of the Industrial Disputes Act, 1947 or any corresponding State law. Most bonus disputes call into question the veracity of accounts maintained by the establishment. The Act is clear in stating that the accuracy of balance sheet cannot be questioned if it is audited by duly qualified auditors or by the Comptroller General of India. For the purpose of record maintenance, the Act provides for the appointment of inspectors by the appropriate government. If any person contravenes any provision or rule of the Act or fails to comply with any direction given to him, he is liable to be punished with imprisonment up to 6 months, or be fined up to ₹ 1000 or be punished with both.

An employer has the right to pay bonus that is linked to productivity instead of profits, if there is an agreement to that effect between him and his employees. But such an agreement should not violate the maximum and minimum bonus criteria established by the Act.

The Act allows the employees the option of voluntarily entering into an agreement or contract with the employer for bonus settlement which is not based on the formula outlined by the Act. But such an agreement should not violate the maximum and minimum bonus criteria established by the Act.

If the appropriate government, considering the financial position and other relevant circumstances of any establishment or class of establishments, is of the opinion that it will not be in public interest to apply the provisions of this Act, it may, by notification in the official gazette, exempt the establishment from all or any of the provisions of the act for a specified period of time. The Act also empowers the appropriate government to subject the establishment to such conditions as it may think fit to impose in that particular situation. The Central government may make rules for the purpose of carrying into effect the provisions of this Act.

12.2.3 The Equal Remuneration Act, 1976

The ideal of 'social justice' which is enshrined in the Preamble is sought to be attained by the State with the help of the directions set by the Directive Principles of State Policy. In pursuance of the ideals of socio-economic justice, the Government of India promulgated the Equal Remuneration Ordinance on 26 September 1975. This ordinance was later replaced by the Equal Remuneration Act, 1976. The primary objective of the Act was to implement Article 39 of the Constitution. Article 39 of the Constitution states that 'the State shall, in particular, direct its policy towards securing, that there is equal pay for equal work for both men and women.'

Main provisions of the Act

According to the Act, the term 'remuneration' includes 'basic wages or salary and any additional emoluments whatsoever payable either in cash or kind, to a person employed in respect of employment or work done in such employment, if the terms of the contract of employment, express or implied were fulfilled.' The Act makes it obligatory for the employer to pay 'equal remuneration to men and women workers for the same work or work of a similar nature.' In other words, the Act prohibits discrimination in wage disbursements on the basis of sex or gender.

Apart from prohibiting discrimination in remuneration payments, the Act further prohibits the practice of discrimination in matters of recruitment 'for the same work or work of a similar nature between men and women workers.' The Act also states that women cannot be discriminated against in conditions of service, such as promotions, training and transfer. In short, the Act aims not only to ensure equal remuneration for women but also attempts to eliminate discriminatory practices against women in relation to recruitment and conditions of service.

The Act further advises the government to form advisory committees which would tender advice on how to increase the employment opportunities available to women. The Act allows the appropriate government to appoint suitable people for hearing and deciding on complaints and claims emerging out of remuneration practices. The appointed authority or official would have powers equivalent to all the powers of a civil court under the Code of Civil Procedure, 1908. The Act allows for appeal against the decisions awarded by the above mentioned authorities. The appeals can be made by the aggrieved employer or employee to the appellate authority within thirty days of order. The Act makes it obligatory for the employers to maintain appropriate records in a prescribed manner. The employer is responsible for maintaining all the employment related paper work. Under the provisions of the Act, inspectors can be appointed by the appropriate government to implement the Act. Besides the implementation mechanisms, the Act also provides for penalties for non-compliance with the provisions of the Act.

The provision of the Act regarding 'equal treatment for men and women' is not applicable in the following situations or cases:

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- Where the conditions of women's employment are based in compliance with the existing law regulating employment of women
- Special treatment given to women employees during pregnancy and child birth

The Act further states that 'if the appropriate government is satisfied that the difference in regard to the remuneration of men and women workers in any establishment, or employment is based on a factor other than sex, it may, by notification, make a declaration that any act of employer attributable to such a difference shall not be deemed to be contravention of any provision of this Act.'

12.2.4 The Payment of Wages Act, 1936

The Payment of Wages Act, 1936 was enacted to regulate the payment of wages to certain classes of persons employed in industry. The regulation seeks to (i) ensure regular and prompt payment of wages, and (ii) prevent exploitation of wage-earners by prohibiting arbitrary fines and deductions from wages. Section 2 (vi) of the Payment of Wages Act defines 'wages' to mean all remuneration (whether by way of salary, allowances, or otherwise) expressed in terms of money or capable of being so expressed which would, if the terms of employment – express or implied – were fulfilled, be payable to a person employed in respect of his employment or of work done in such employment, and includes:

- Any remuneration payable under any award or settlement between the parties or order of a court
- Any remuneration to which the person employed is entitled in respect of overtime work or holidays or any leave period

Application of the Act

The Payment of Wages Act, 1936 extends to the whole of India. It applies to the following persons:

- Persons employed in any factory
- Persons employed (otherwise than in factory) upon any railway by a railway administration either directly or through a subcontractor, by a person fulfilling a contract with a railway administration
- Persons employed in an industrial or other establishment specified in sub-clauses (a) to (g) of Clause (ii) of the section.

The Act empowers the State Government to extend the application of the whole or part of the Act to any class of persons employed in the establishment or class of establishments specified by the Central/State Government under Section 2(h) (ii). The Act applies to persons drawing less than six thousand five hundred rupees a month.

Authorities under the Payment of Wages Act

Section 15 empowers the state governments to appoint an authority by the issue of notification for a specified area to hear and decide and dispose of all claims arising out of deductions from wages or delay in payment of wages of persons employed or paid in the area, including all matters incidental to such claims.

I. Who may be appointed: Any of the following persons may be appointed as an authority for the above purposes:

a. Presiding officers of a Labour Court or Industrial Tribunal constituted under the Industrial Disputes Act, 1947 or under any corresponding law relating to the investigation and settlement of industrial disputes in force in the State

b. Any Commissioner for Workmen's compensation

c. Other officer with experience as a judge in a civil court or as a Stipendiary Magistrate

II. Who may file the application: If the payment of wages is delayed beyond the due date or deductions are made from wages contrary to the provisions of the Act, an application for recovering the same can be filed either by an employee himself or a legal practitioner or an official of a registered trade union duly authorized in writing by the employee, the inspector or by any other person with the permission of the authority hearing the claim. If there are several employees borne on the same establishment and if their wages for the same period have remained unpaid after the due date, a single claims application can be filed on behalf of all such employees.

Similarly, if several applications are filed by employees belonging to the same unpaid group, the authority can deal with them as if it was a single application by an unpaid group.

Limitation

Every such application has to be presented within one year from the date on which the payment of wages was due or from the date on which deductions from wages were made. The authority has, however, been given the power to condone the delay in filing such application on its being satisfied that there was a 'sufficient cause' for not filing the application within the time prescribed.

Let us consider an example of the decision arrived at with regard to the Payment of Wages Act, 1936, Sections 1(6), 2(i) and 15. In *Damodaran P. and others* v. *M.K. Krishna Kutty,* [(2006) 3 LLJ 407], an employee whose salary was ₹ 850 per month, filed a claim petition under Section 15 of the Payment of Wages Act, 1936, claiming arrears of wages. The employer resisted the claim, contending that the employee was employed in a managerial capacity and hence he was not entitled to any claim under the Payment of Wages Act and the Authority

under the Act had no jurisdiction to deal with the claim. Finally, the matter reached the Kerala High Court. The High Court held that the employee was entitled to make a claim under the said Act, for the following reasons:

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- Section 2 (s) of the Industrial Disputes Act, 1947, while defining 'workman', specifically excluded persons employed mainly in a managerial or administrative capacity and persons employed in supervisory capacity drawing more than ₹ 1,600/- per month. Unlike the provisions under the Industrial Disputes Act, there is no exclusion or exemption for persons employed in a managerial capacity or administrative capacity under the Payment of Wages Act.
- The only condition is that the person who is filing the petition should be employed during the relevant time. Section 1 (6) of the Act makes it clear that the Act is applicable to all employed persons whose salary is less than ₹ 1,600/- per month.
- The definition of 'workman' under the Industrial Disputes Act, 1947 cannot be adopted for the term 'employed person' used in the Payment of Wages Act, 1936. The petitioner admittedly was employed in the establishment during the period for which claim for arrears of wages was made and his salary was below ₹ 1,600/- per month.
- In view of the above admitted facts, the petitioner is entitled to claim under the Payment of Wages Act and his claim cannot be rejected on the ground that he was employed in a managerial capacity.

Check Your Progress

1. Who are responsible for implementing the Minimum Wages Act with regards to a state?
2. What is the main objective of the Payment of Bonus Act?
3. When is an employee not entitled for a bonus?
4. Who are the people covered under the Payment of Wages Act, 1936?

12.3 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Within the ambit of State, the Minimum Wages Act holds the officers of the industrial relations machinery responsible for the implementation of the Act and other labour laws as well.
2. The main objective of the Payment of Bonus Act is to assuage the workers in order to maintain harmony between the labour and capital by allowing the employees a share in the prosperity of the firm.

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3. An employee is not entitled for a bonus, if he is dismissed from the service on following grounds:
   a) Misappropriation of funds or attempting to defraud the establishment
   b) Indulging in unruly and inappropriate behaviour within the establishment premises
   c) Stealing or damaging property belonging to the establishment
4. The Payment of Wages Act, 1936 extends to the whole of India. It applies to the following persons:
   a) Persons employed in any factory
   b) Persons employed (otherwise than in factory) upon any railway by a railway administration either directly or through a subcontractor, by a person fulfilling a contract with a railway administration
   c) Persons employed in an industrial or other establishment specified in sub-clauses (a) to (g) of Clause (ii) of the section.

12.4 SUMMARY

- Wage policy in the Indian context is a sensitive topic because it not only affects the economy, but also society in general.
- The Minimum Wages Act, 1948 is a piece of social legislation which aims at extending the principle of social justice that is enshrined in our Constitution to the workers of India. The Act seeks to provide protection to workers in employment where they are open to exploitation by unscrupulous employers.
- Unlike the traditional view where bonus was perceived as charity of the employers, the modern worker sees it as a rightful share in the profits of the company. The main objective of the Payment of Bonus Act, 1965 was to assuage the workers in order to maintain harmony between the labour and capital by allowing the employees a share in the prosperity of the firm.
- In pursuance of the ideals of socio-economic justice, the Government of India promulgated the Equal Remuneration Ordinance on 26 September 1975. This ordinance was later replaced by the Equal Remuneration Act, 1976. The primary objective of the Act was to implement Article 39 of the Constitution.
- The Payment of Wages Act, 1936 was enacted to regulate the payment of wages to certain classes of persons employed in industry. The regulation seeks to (i) ensure regular and prompt payment of wages, and (ii) prevent exploitation of wage-earners by prohibiting arbitrary fines and deductions from wages.

12.5 KEY WORDS

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- **Wages:** It refers to all remuneration (whether by way of salary, allowances or otherwise) expressed in terms of money or capable of being so expressed, which would be payable to a person employed in respect of his employment or of work done in such employment.
- **Wage period:** It refers to the period in respect of which wages shall be payable.

12.6 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. What are the main provisions of the Minimum Wages Act, 1948?
2. What is the Payment of Bonus Act, 1965 all about?
3. Which authorities have the power under the Payment of Wages Act and how are they chosen?

Long Answer Questions

1. Discuss the different aspects of the Minimum Wages Act, 1948.
2. Describe the features of the Payment of Bonus Act, 1965, along with its accounting year.
3. Evaluate the limitation of the Payment of Wages Act.

12.7 FURTHER READINGS

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UNIT 13 CURRENT TRENDS IN COMPENSATION

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Structure

13.0 INTRODUCTION

In every organization, there are different kinds of workers having different knowledge base and different skill sets working towards attaining the common goals of the organization. In return for their efforts, the workers and employees are compensated by the organization according to the contribution they make to the organization. In order to fairly compensate the workers and employees for their efforts almost every organization has a compensation structure in place. The compensation structure is carefully designed by the organizations after systematically considering various factors. In fact, designing a fair compensation structure is a challenge, but most organizations have been successful in meeting that challenge.

In this unit, we will discuss about the ongoing trends in compensation management. How the companies design a compensation plan for their employees considering the critical role they play in the company. The components of executive compensation package have also been discussed in the unit. In addition to this, you will also study about the approaches used for compensating expatriates and analyse the balance sheet approach which is the most popular method for remunerating expatriates.

13.1 OBJECTIVES

After going through this unit, you will be able to:

- Explain the various compensation packages of executives
- Discuss the meaning, challenges and scope of international compensation

- Describe the components of international remuneration
- Analyse the compensation for professionals and knowledge workers

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13.2 EXECUTIVE COMPENSATION

Executive compensation package consists of the following five basic elements:

- Base salary
- Short-term incentives
- Long-term incentives
- Employee benefits
- Perquisites

Base salary: Most organizations determine the base salary of an executive by 'sequentially engaging' in job analysis, job evaluation, salary surveys and pay guidelines for performance and promotions. Besides these formal methods, Daly and Johnson point out that the opinion of the compensation committee consisting of board of directors plays a vital role in the determination of base salary of an executive. The base salary of an executive reflects his extent of experience and level of performance in a particular job of importance to the company. More often than naught, it is the base salary which forms the basis for the determination of the rest of the four components of his package. Unlike some other components of an executive's compensation package, the base salary is a no risk form of pay because it is never reduced.

Short-term incentives: These short term incentives are included in the executive compensation package to reward accomplishment of short term targets and to motivate performance. These incentives are designed to include the downside risk and the upside potential. Since these incentives are tied to performance, the amount of payments received by the executives vary annually. By tying short term incentives to performance, the organization benefits in both situations of low and high performance. In case of low performance the organization does have to bear the cost of fixed incentive while during high performance it provides avenues for the executive to maximise his reward potential. In other words the financial results of the company has a significant bearing on the executives short term incentives.

Short-term incentive plans vary from individual rewards for individual achievements to more sophisticated profit sharing plans which focus on divisional or organizational performance. The problem with profit sharing plans for organizational performance is that it tends to overpay marginal performers during profitable years and underpay high performers during lean years. Economic profit, earnings per share, return on assets and cash flow are the common financial measurements used for computing short-term incentives. Along with financial measurements, some organizations also are measurements like customer

satisfaction, new products, work place issues, etc. Short-term incentives are usually made by cash but some incentive plans may include a combination of cash and shares of stock.

Long-term incentive: These incentives are similar to short-term incentives in most respects, except the duration of performance period which is multi-year. Unlike short-term incentives, these incentives tie payments to achievements of business objectives. In other words, 'the executive has a portion of pay placed at risk with degree of attainment of business objectives'. In case of non-achievement of business objectives, the executive is either not paid any incentive or is paid a token amount which is akin to being served with a termination notice. Long-term incentives provide the organization with the power to retain the services of the executive for a longer duration and at the same time motivates the executive to perform as his portion of pay is tied to results. These incentives are usually based on shareholder value or the financial performance of the defined division or the unit.

According to Jeffery Hyman, following are the objectives of long-term incentives for executives (Table 13.1):

- Sharing the company's success with executives
- Promoting long-term thinking
- Aligning the executive interest with that of shareholders interest (refer to Table 13.2)
- Attracting and retaining talented executives
- Supplementing the employee retirement income programmes

Table 13.1 *Long-Term Incentives for Executives*

Type	Description
Incentive stock option	Purchase of stock at a stipulated price conforming to regulatory codes
Non-qualified stock options	Purchase of stock at a stipulated price not conforming to regulatory codes
Phantom stock plans	Cash or stock award determined by increase in stock price at a future date
Stock appreciation rights	Cash or stock award determined by increase in stock price during any time chosen (by the executive) in the option period
Restricted stock plans	Grant of stock at a reduced price with the condition that it may not be sold before a specified date
Performance share/unit plans	Cash or stock award earned through achieving specific goals

Source: B. Ellig *The Complete Guide to Executive Compensation.*

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Table 13.2 Stakeholders' views on Stock Options

	Recipient	Company	Shareholders
Upsides	▪ Flexible ▪ Can receive lower capital gains tax rates ▪ Large potential gains possible	▪ No cost to company ▪ Positive cash flow on employee exercise ▪ Corporate tax deduction on employee exercise	▪ Encourages appropriate risk taking ▪ Better incentive alignment through potential ownership ▪ Focuses management behavior on the long run
Downsides	▪ Improper tax related decisions can be catastrophic ▪ Under diversified wealth possibilities ▪ Investment risk if stock prices decline	▪ Underwater options can reduce employee morale ▪ Falling stock prices can reduce ability to attract and retain employees	▪ Dilution of equity ▪ Repurchases may lead to less investment in long term projects that would benefit share holders ▪ Performance gaming ▪ Limited long- term ownership by executives

Source: Cynthia D. Fisher, Lyle F. Schcenfeldt, James B. Shaw.

Employee benefits: Executives receive higher benefits than other employees because most of their benefits are tied to income levels for instance, life insurance, pension plans, etc. Along with the usual employee benefits, the company provides the executive with additional life insurance, exclusions from deductibles for health related costs, and supplementary pension incomes. We shall study more about employee benefits further in the unit where we will be discussing benefits as an independent topic.

Perquisites: Also known as executive benefits, 'perks' are basically to supplement the employee benefit coverage. Executive perquisites can be grouped into three categories, internal, external and personal. Internal perks refers to the 'something extra' that company provides for the executive within its space for instance, a luxury office, private parking etc. The second category is also company related but are provided when the executive conducts business externally, for instance club memberships, executive class air travel, etc. The personal category of perks provided by the company are low cost loans, company paid family vacations, use of company property etc. These perks are not uniform for all the executives as they tend to vary with organizational levels and in some companies they are

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rationalized to the extent of delivering it in a tax effective manner. Perks are not suitable for behaviour modification as they are rarely discontinued by the company. The value of perks is more intrinsic to the executives than being extrinsic. In Table 13.3 we shall list the perks offered to executives as compiled by Hewitt Associates.

Table 13.3 *List of Perks Offered by Companies to Executives*

Perks	Companies Offering Perk
Company car	68%
Financial counseling	64%
Company plane	63%
Income tax preparation	63%
First class air travel	62%
Country club membership	55%
Luncheon club membership	55%
Estate planning	52%
Personal liability insurance	50%
Spouse travel	47%
Chauffer service	40%
Reserved parking	32%
Executive dining room	30%
Home security system	25%
Car phone	22%
Financial seminars	11%
Loans at low or no interest	9%
Legal counseling	6%

Source: Milkovich and Newman *Compensation.*

Check Your Progress

1. Name the five basic elements of executive compensation.
2. What is perquisite salary?
3. What are the different categories of perks which are available to executives?

13.3 INTERNATIONAL COMPENSATION – CHALLENGES AND SCOPE

The growth and spread of communication technology has made national boundaries nothing but mere 'shadow lines' and this blurring of global boundaries has made globalization a reality which most companies of any size has to face. Globalization has not only integrated the markets but also has facilitated increased movement of

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capital and labour across national boundaries. As companies increase their footprints across the world, they are increasingly faced with the issue of developing an internationally equitable compensation system. Because of its complex nature, international compensation receives more than its share of attention from companies which operate in a multinational environment. Some of the complexities involved in international compensation are as follows:

- Balancing centralization and decentralization of incentives
- Balancing pensions and benefits
- Developing detailed performance metrics for international assignees
- Outsourcing activities and labour pricing needs
- Assessing cost realities of different operating environment

For companies operating in multinational environment it is necessary for them to consider tax laws, customs, environment, employment practices, and labour regulations while designing a compensation package. Further while determining remuneration for international assignees, the company has to consider factors like currency fluctuations, inflation etc. The company also has to understand the context for providing different kinds of allowances for the employees as the nature of allowances differ from country to country, for instance in case of hardship allowances, the allowance for a terrorist affected city will be different from an environmentally harsh country.

Apart from the country specific variables, it is crucial that company understands the type of employees hired by it for international assignments. Speaking of types of employees, in the following section we will define the types of employees who operate in international arena.

Categories of international employees

Most organizations which have an international presence employ three kinds of workers, namely, expatriates, local country nationals (LCNs) and third country nationals (TCNs).

1. **Expatriate:** A citizen of a country in which organisation's headquarters is domiciled. Expatriates are employees assigned to work in another country.
2. **Local country nationals or LCNs:** LCNs are citizens of the country in which the subsidiary or a branch is located for example a Sri Lankan working for an Indian company in Colombo. There are several advantages of using LCNs:
   - They may cost less than employing expatriates.
   - They are fluent in host country's language.
   - They are familiar with local cultural norms.
   - They are more effective in dealing with local customers.

3. **Third country nationals or TCNs:** TCN is neither a citizen of the organization's country of origin nor a citizen of the country where the organization's foreign facility is located. For example, a Chinese working for an Indian company in its Singapore branch is a third country national. TCNs are often employed by companies because
   - They cost less than expatriates.
   - They may be fluent in several languages.
   - They may have previous international experience which can be useful for the company.

Objectives of international compensation programme

Following are some of the objectives an international compensation program:

1. **Attraction and retention of employees:** Just as any other compensation or incentive scheme, the basic objective of international compensation package is to attract and retain employees who are suitably qualified for international assignments. The compensation package must be such that it is able to attract and retain staff in countries or areas where the company has the greatest needs and opportunities. Therefore the compensation package must be competitive and inclusive of Foreign Service premiums, equalization benefits and other allowances which can make international assignments look attractive.
2. **Facilitation of transfer:** The companies must design international compensation package which will facilitate transfer of employees between foreign affiliates and the parent company (that is Headquarters) and between parent company and foreign locations (branches). The compensation policy must be such that it allows for smooth transfer of international employees between assignments in a cost effective manner for the firm.
3. **Facilitates consistent relationship:** The compensation package must be such that it allows for establishment and development of consistent relationship between all international employees. In other words, the compensation policy must engender consistency between employees of all affiliates, both at parent station and abroad.
4. **Competitive:** The international compensation package must be relative to the compensation practices of the competitors and at the same time it must be cost effective for the company.
5. **Should make the assignment attractive:** The compensation package for international assignments should be designed in such a manner that it should make taking up international assignment attractive for the employee. In practice the compensation package *per se* must act as proverbial 'carrot' for the employee.

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6. **Should provide for a certain lifestyle:** Since the employee is taking up assignment in a country which is new to him and for his family, the compensation package must be such that it provides for a reasonable standard of living for the employee. The package must take care of all his living needs along with the needs of his family. In fact it must also consider the employee's career needs as well.
7. **Facilitate re-entry:** Repatriation of an employee after an international assignment is always a tricky affair, but the compensation package can be used effectively for smoothening the re-entry of the employee into the home country at the end of an international assignment.
8. **Consistent with business strategy:** It would make poor sense if the international compensation package is not aligned with the business goals of the company. Therefore the design of international compensation package is consistent with the company's overall strategy and business needs.
9. **Ease in administration:** Developing a complex compensation package means complex administrative procedures and equally difficult administration. Therefore the compensation policy must consider equity and ease of administration as well.

All the above mentioned objectives were from an organization's point of view, but the employees also has the following expectations from the compensation package.

(a) **Financial protection:** This is the most fundamental expectation which an employee has from an international compensation package. The employee will judge the compensation package from the financial protection it offers. The package must cover not only the employee's living needs, it must also take care of his and his dependents social security needs.

(b) **Financial advancement:** After the social security needs, the employee expects the foreign assignment to offer opportunities for financial advancement. He will find the package attractive if the assignment offers him avenues for financial savings or income generation.

(c) **Social needs:** The employee will expect the compensation package to care of his social needs such as his children's education, his recreational needs etc.

In order to achieve the above mentioned objectives, most companies end up paying a high premium over the base salaries to induce managers to accept overseas assignments. Research points out that the cost of maintaining a manager in foreign location ranges from two and a half times to four and a half times the cost of maintaining the manager at home.

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Components of international remuneration

Following are the four components of an international compensation package:

1. **Base Salary**: Two approaches are used for determining base salary for an international employee:
   - Following the well-established practices of the parent company
   - Following the practices of the country where the employee is posted or works
2. **Indirect Monetary Compensation:** This refers to the benefits package offered to the employee and this is usually the same as one which is provided by home country. But the composition of benefits package may differ from country to country and may even consist of benefits which are not offered in the home country. For example in France employers are required by law to provide every employee with 25 days of vacation.
3. **Equalization Benefits:** These are benefits which are provided to keep the employee in the same financial condition as they were before taking up an international assignment. The objective of equalization benefit is to reduce the negative effects of living in a foreign country. Following are some examples of equalization benefits offered by the companies.
   - Housing allowance
   - Educational allowance for children
   - Foreign service premium
   - Assignment completion bonus
   - Emergency leave
   - Home leave
   - Language training
   - Domestic staff
   - Club membership
   - Spousal employment
   - Cultural training for family
4. **Incentives:** Incentives provided by companies may range from cash bonuses to stock options.

Designing an international compensation package requires detailed assessment of specifics of the assignment and employee involved. In fact we are keeping our discussion on elements and approaches to international compensation brief because we intend to cover it in detail in the next section where we will be discussing expatriate compensation.

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Compensating Expatriates

Organizations which depute employees on international assignments are more than often faced with the tricky decision of how to compensate such employees or what should be the approach used for compensating such employees. The company has to grapple with the issue of dealing with two labour markets i.e. the parent country market and host country market. With such complex issues involved in designing expatriate compensation package no wonder that such packages are expensive and complex. Almost all companies which operate internationally use one of the following two approaches for designing expatriate compensation package.

Approaches to expatriate compensation

The Chartered Institute for Personnel and Development UK identifies two basic approaches for designing expatriate compensation (Table 13.4):

1. **The balance sheet method:** Also known as home country approach because employers offer compensation packages which enables the expatriates to maintain their home living standards while on an international assignment. This approach considers the differences in taxation and cost of living and also adds an attractive incentive package to make it appealing for the expatriate. The approach relies on concept of disposable income as it is this part of the compensation that reflects the cost of living differences between the home and host country. The whole objective of this approach is to enable the expatriate lead a life which he would otherwise lead at home on a specific salary.
2. **The host country method:** In this approach the expatriate is offered the same package as the host country nationals performing the same jobs. This implies that the expatriate makes all the local payments such as social security payments, local taxes etc. But the companies may offer some additional benefits in form of free housing, children's educational allowance, Foreign Service premiums etc.

The above-mentioned approaches are the two basic approaches used for compensating expatriates, but some companies combine both the approaches and develop a compensation package which reflects a hybrid approach. In Table 13.4 we have summarized all the three approaches along with their advantages and disadvantages.

Table 13.4 Summary of Approaches to Expatriate Compensation

	Home based	Host based	Hybrid
Features	Consistent treatment of expatriates of the same nationality. Link with home country economy and structure. Different pay levels for different nationalities. No relationship with local employees.	Equity with local nationals All nationalities paid the same Simple administration Variation in value by localities No link to home country or structure	All nationalities are paid equitably Some link to home country economy and structure No relationship to local employees
Applicable conditions	Temporary international assignment. Expatriates will ultimately be repatriated to their country of origin. The number of different nationalities in any one host location is relatively low. International staff predominate higher level host location jobs	International assignments of indefinite duration. The number of different nationalities in any one host location is high Host country local staff predominate in higher level host location jobs.	
Advantages	Expatriates neither gain nor lose financially. Facilitates mobility Eases repatriation	All employees operate on equivalent pay System is easy to administer All employees including expatriates are paid the same Most suitable for international assignments of	All expatriate nationalities are paid equitably Assists transfer and development of an international management cadre

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Despite the presence of the above mentioned approaches, most companies prefer following the balance sheet approach for compensating expatriates and in the following paragraphs we will be discussing the balance sheet approach in detail.

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Balance sheet method

The objective of this approach is that 'the expatriate should not suffer a loss as a result of transfer.' This general goal of trying the 'keep the expatriate whole' is the stated objective of compensation packages of companies which operate internationally. In pursuit of this objective most companies design compensation packages which keeps the expatriates' standard of living on par with that of their contemporaries at home. Balance sheet method links the base salary of the expatriate and Third Country Nationals to the salary structure of their home country. For example, an Indian executive of an Indian multinational taking up an international assignment would have his compensation package built upon the Indian base salary level than that applicable to the host country. The assumption behind linking base salary of the Indian employee to Indian levels is to ensure that the employee does not suffer material loss due to transfer. This in brief is the balance sheet method of determining the expatriate compensation.

According to Reynolds, 'the balance sheet approach to international compensation is a system designed to equalize the purchasing power of employees at comparable position levels living overseas and in the home country and to provide incentives to offset qualitative differences between assignment locations.'

The important characteristics of balance sheet method are as follows:

- Primary objective of this approach to expatriate compensation is to ensure maintenance of home country living standards
- Home country pay and not the host country pay is the basis of this approach
- The approach makes adjustments to home compensation packages in order to balance the additional expenditure which may be incurred in host country.
- Most popular and prevalent approach used for compensating expatriates.

Balance sheet approach incorporates the following four categories of outlays incurred by expatriates:

(i) **Goods and services**: Home country outlays for items such as food, personal care, clothing, household furnishings, recreation, transportation and medical care.

(ii) **Housing:** The major costs associated with housing in the host country

(iii) **Income taxes:** Parent country and host country income taxes

(iv) **Reserve:** Contribution to savings, payments to benefits, pension contributions, investments, education expenses, social security taxes etc.

This approach seeks to balance the costs when the costs associated with the host country assignment exceeds the equivalent costs in the home country. This balancing is primarily undertaken for ensuring that the expatriate has an equivalent living standard as his contemporaries at home.

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Table 13.5 shows a typical spread sheet for an expatriate assignment using the balance sheet approach. In this example, an Indian expatriate is assigned to a country called New Land which has a cost of living index of 150 relative to India and an exchange rate of 1.5 relative to the Indian Rupee. In addition to Foreign Service premium, a hard ship allowance is also payable for this location. Housing is provided by the firm, and a notional cost for this is recognized by a 7 per cent deduction from the package, along with a notional tax deduction. The expatriate can see from the spread sheet what components are offered in the package and how the package will be split between Indian rupees and the new land currency (franc).

Table 13.5 *Expatriate Compensation Work Sheet*

Employee:	Vikas Joshi
Position:	Production Manager
country:	New Land
Reason for change:	New assignment
Effective date of change:	1 January 2009

Item	Amount in Indian Rs per annum	Paid in Indian Rupees	Paid in local currency NL Franc
Base salary	200,000	100,000	150,000
Cost of living allowance	50,000		75,000
Overseas service premium (20%)	40,000	40,000	
Hard ship allowance (20%)	40,000	40,000	
Housing deduction (7%)	-14,000	-14,000	
Tax deduction	-97,000	-97,000	
Total	219,000	69,000	225,000
COLA index = 150			

Advantages and disadvantages of balance sheet approach

Following are some of the main advantages associated with balance sheet approach:

I. **First**, it provides equity between foreign assignments and between expatriates of the same nationality.

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II. Second, balance sheet approach by emphasizing on equity with home country or parent company facilitates fairly smooth repatriation of expatriates. Balance sheet approach avoids compensation related issues while repatriating expatriates because the whole compensation package is rooted to the compensation practices of the parent company.

III. Third, it is an approach which is simple and easy to communicate to the employees.

The two main disadvantages associated with balance sheet approach are as follows:

1. Firstly, the balance sheet approach can lead to significant disparities between expatriates of different nationalities and between expatriates and the host country nationals. This approach creates problems when international employees are paid according to their home base salary. Paying international employees on the basis of home base salary means that they are paid different amounts compared to the host country nationals for performing the same job in host location. For example, in the Dubai regional headquarters of a US bank, a US expatriate and an Indian third country national may perform the same banking duties but the American will receive a higher salary than the Indian because of the differences in the US and Indian base salary levels. From this example it is clear that following home base salary creates disparities among expatriates of different nationalities. Similarly differences in base salaries also creates pay disparities between expatriates and host country nationals. Such pay disparities can create resentment among host country nationals much to the disadvantage of the company in that specific country.

   In practice the feelings of inequity is also visible on the other side i.e. there are situations where the expatriate may be underpaid as compared to the host country nationals. For example, if an international company operates a subsidiary in US will find itself in a very peculiar situation with respect to compensation. The expatriates from home country working in US will find themselves underpaid when compared to US nationals because US has the highest level of managerial compensation in the world. Therefore balance sheet approach can create disparities both ways around i.e between expatriates and host country nationals and between host country nationals and expatriates.

2. Secondly, the balance sheet approach may sound conceptually simple, but in practice it can be complex to implement and administer (refer to Table 13.6).

Table 13.6 Summary of Advantages and Disadvantages of Balance Sheet Approach

Advantages	Disadvantages
Equity • Between assignments • Between expatriates of the same nationality	Can result in great disparities • Between expatriates of different nationalities • Between expatriates and local nationals
Facilitates expatriate re entry	Can be quite complex to administer
Easy to communicate to employees	

From expatriate compensation point of view more than base salary it is the incentives and equalization benefits which form the crucial component as they are the elements which make the compensation package attractive to the expatriate. And in this section we shall be focusing our attention on this crucial component of expatriate compensation package.

Incentives to expatriates

After determining the approach to base salary, the company focuses on the tricky and sensitive issue of incentives and benefits. More than base salary it is the incentives and benefits component which are used by the companies to induce employees to take up international assignments. The benefits package is used for convincing the employee that international assignments will work out to their financial advantage. In pursuit of this objective companies offer numerous benefits as part of compensation package. The aim of incentives and benefits package is to:

- Compensate the expatriate for all the adjustments that he will have to make during the assignment
- Compensate the expatriate and his family for the dislocation
- Compensate the expatriate for living and working in what can be an inhospitable environment
- Act as an inducement for employees to take up international assignment
- Match the compensatory practices of other companies having similar international operations.

The incentives are inclusive of foreign service premiums, cost of living allowances, relocation allowances etc. Table 13.7 will give you an idea of incentives offered by companies to expatriates. Speaking of foreign service premiums, earlier these premiums used to average about 25 per cent of the expatriate's base pay. But now it has come down to about 15 per cent of the base pay. Companies vary their premiums on the basis of cost of living of that specific host country. For instance, premiums were higher for high cost living postings such as Tokyo, Geneva, or Brussels. Incentives also cover the cost of living disparities between one city and another and intercity living disparities can be quite glaring, for instance the

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annual cost of living for a family of our from New York having a US salary of 75,000 dollars in 2002 was 63,750 dollars in Johannesburg, 90,000 dollars in Moscow, 108,000 dollars in Stockholm and London and 137,250 dollars in Tokyo. To make up for all the cost of living disparities incentives are offered to the expatriates and the compensation package is designed to ensure that the expatriate has a standard of living comparable to his home country.

Table 13.7 *Incentive Offered to Expatriates*

Incentive Components
• Overseas/foreign service premiums
• Compensation for life adjustments (displacement allowances, unfamiliar country, uncomfortable/harsh/dangerous environment)
• Relocation/travel expenses; house hunting expenses; shipment and storage of house hold goods; furnishings for foreign housing; home sale protection; rental assistance; automobile shipping or sale protection.
• Temporary living expenses
• Housing allowance: comparable to original home; comparable to foreign peers; utilities allowance
• Education allowance for self, children, spouse; language and cultural training allowance
• Spousal support: education, income replacement, employment services, and career planning
• Perquisites, e.g., club memberships, home leave, R & R leave, company car and driver
• Tax preparation assistance
• Financial advice
• Expatriation counseling
• Home country career support and counseling
• Repatriation assistance and planning

Source: Dennis R. Briscoe, Randall S. Schuler, *International Human Resource Management.*

Hardship incentive

Besides providing for cost of living disparities, the incentive package also covers what is known as dangers of 'hardship postings.' Most companies provide hardship incentives to employees who take up assignments in developing countries, locations where the threat of kidnapping or terrorist activity is high, or to remote locations (such as rain forests of Brazil or on an ocean oil drilling platform) or locations with primitive living conditions. For the purpose of determining hardship allowances, companies distinguish between three categories of hardship i.e. physical threat, level of discomfort, and inconvenience.

- The physical threat category consist of areas which are prone to violence, which are hostile to foreigners, which are prone epidemics and which lack adequate medical and health facilities.
- The discomfort category is related to physical environment and climate of the area, its geographical, cultural and psychological isolation
- The inconvenience category rates the local education system, the availability and quality of local housing, access to recreational and community facilities and the availability, quality, and variety of consumer goods and services.

In most companies hardship allowances usually range from 5 per cent to 25 per cent of base pay, while the allowance for 'dangerous posting' may add to another 15 to 20 per cent of the base pay. In other words, hardship allowances and danger pay incentives can easily add up to 30 to 40 per cent of the expatriates' base pay. An example of what corporations provide for hardship pay is provided by these results of a survey of MNCs from a few years ago in the Middle East for the per centages of base pay added to expatriate compensation for assignments to the area: UAE (12.5 per cent), Bahrain (20 per cent), Egypt (20 per cent) Saudi Arabia (25 per cent), Israel (42.5 per cent).

Equalization adjustments

Apart from the numerous incentives offered by the company to the expatriates, the multinational companies also offer what is known as equalization adjustments. According to Berger: 'These are payments whose purpose is to adjust for differences (usually in a higher direction) in mandated payments that expats have no control over- some of which are paid by the expat and some of which are paid to the expat.'

Equalization adjustments include compensation for any items such as:

- Fluctuations in exchange rates between the expatriate's home country currency and that of host country currency
- All locally mandated payments, such as payment of salary for additional days or weeks per year (in many countries, firms must pay employees for thirteen to fourteen months every year, or as in Saudi Arabia must pay for seven days work per week, i.e. must pay for the rest days as well as for the work days)
- Adjusting for decreases in the value of the expatriate's income due to high inflation in the host country
- An allowance to adjust for differences in the (higher) costs of living
- Reimbursement for any mandatory payments into the host country's welfare plans such as health insurance or social security
- Allowances for ensuring that the expatriate will not have to pay more in income taxes while on the foreign assignment than he would have to pay while at home.

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Among all the equalization adjustments the most common is the cost of living adjustments (COLA) and this is offered by almost all companies to expatriates. The main objective behind cost of living adjustments is to provide the expatriate with the same standard of living in the foreign assignment that he would have had at home. The cost of living adjustments is determined by calculating the cost of typical goods and services in the home country as well as in the host country and adjusting accordingly.

Some equalization adjustments are as follows:

- Cost of living adjustments
- Reimbursement for payments into host country welfare plans
- Income taxes—withheld from home taxes, pay local taxes; equalization and protection
- Protection for fluctuation in exchange rates; inflation
- Employee benefit adjustments (pension, retirement savings plans, health care)

13.3.1 Scope of International Compensation

International compensation is aimed to enable the organizations to attract potential candidates and should match the local and regional standards. The scope of international compensation should be viewed from the perspective of the multinational firm and also from expatriate's view.

From the Perspective of a Multinational Firm

While developing international compensation policies, a firm seeks to satisfy several objectives. First, the policy should be consistent with the overall strategy, structure and business needs of the multinational. Second, the policy must work to attract and retain staff in the areas where the multinational has the greatest needs and opportunities. Thus, the policy must be competitive and recognize factors such as incentive for Foreign Service, tax equalization and reimbursement for reasonable costs. Third, the policy should facilitate the transfer of international employees in the most cost-effective manner for the firm. Fourth, the policy must give due consideration to equity and ease of administration.

From the Perspective of an Expatriate

The international employee will also have a number of objectives that need to be achieved from the firm's compensation policy. First, the employee will expect that the policy offers financial protection in terms of benefits, social security and living costs in the foreign location. Second, the employee will expect the foreign assignment to offer opportunities for financial advancement through income and/or savings. Third, the employee will expect that issues such as housing, education of children and recreation will be addressed in the policy.

If we contrast the objectives of the multinational and the employee we see the potential for many complexities and possible problems since some of these objectives cannot be maximized on both sides. The firms must rethink the traditional view of international compensation and accept that local conditions dominate compensation strategy.

Reasons for Differences in Compensation between Countries

While we are still discussing the purposes or objectives of international compensation, it is relevant to look at the major factors generated due to differences between countries. Some factors which have an impact on compensation are:

1. These differences are the result of differences in *prosperity* and the *spending power* of the company. A related factor is the different tax and social security system in the country.
2. The *institutional frameworks* within which wage bargaining takes place are quite different in countries. In Germany and Switzerland, bargaining takes place at the national or industry level. The more negotiations conducted at the national or industry level, the more will be the societal influence on such negotiations. Where there is increased *decentralization* of the negotiating framework level, *company specific* issues become relatively more important.
3. *Cultural differences* between countries have an important impact. These differences do not so much influence the rates of pay as the total *apportioning of the total sum* between wages, incentives and benefits and due to appraisal methods.
4. There may be considerable *differences between organizations and industries*. This may be the result of a deliberate policy, or differences in productivity, labour–capital ratios and situations on the relevant labour market.

13.4 PLANNING COMPENSATION FOR EXECUTIVES, KNOWLEDGE WORKERS AND R&D STAFF

According to Juani Stewart, 'knowledge workers can be defined as employees who apply their valuable knowledge and skills (developed through experience) to complex, novel and abstract problems in environment that provide rich collective knowledge and relational resources.'

Knowledge workers as defined by Drucker 'are individuals who have high levels of education and special skills combined with the ability to apply these skills to identify and solve problems.'

Traditionally employees were compensated by companies for the value they added in terms of productivity or 'what they did' but all this is changing with the

invasion of technology and information into the worker's domain. With the coming of information age, companies have started recognizing workers for what they know and also have started compensating them for what they know. Such employees who add value simply because of what they know are usually referred to as knowledge workers. Knowledge workers include computer professionals, scientists, engineers, research personnel and they tend to work in high technology firms and are usually experts in some abstract knowledge base. As the importance of information driven jobs grows the need for knowledge workers also grows.

Organizations which rely more on knowledge workers are distinct from organizations which rely on conventional workers, and for convenience we call the former organizations as innovative organisations while the latter as operating organisations. Just like conventional operating organizations, innovative organizations also have pay and compensation structure in place but their compensation system is a trifle different from those of the operating organisations. The difference lies in the objective of the compensation system i.e. to motivate innovative behaviour. Since the whole process of innovating is different from say operational tasks, it is rather plain to see as to why innovative organizations have a different kind of reward system. Innovative organisations have reward systems which aim to reward knowledge worker on the basis of his long term commitment and risk taking. In an innovative organization, the function of compensation system is as follows:

- Since innovative talent is a rare commodity, therefore most organizations devise their compensation system with the primary motive of 'attracting' and 'holding' the knowledge workers. In fact the objective of 'attracting and holding' sounds similar to the objectives of every organization, but in case of innovative organizations the objective of 'attracting and holding' assumes added significance because of the nature of their work and business.
- The prime objective of compensation system in an innovative organisation is to motivate that proverbial 'little extra' from the knowledge worker. The idea is to motivate the worker to sustain his innovative efforts despite successive his failure.
- Finally, besides motivation the compensation system must reward the knowledge worker on successful accomplishment or performance.

In practice, innovative organizations design compensation or pay systems to encourage 'internal motivation' by giving opportunities to the knowledge worker to pursue his ideas, by providing promotional avenues and by acknowledging his contribution by giving him incentives or special compensation. In fact it is the 'autonomy' and 'opportunity' which motivates the knowledge worker and the compensation system or pay plan is designed to provide both to the knowledge worker.

With the growing importance of knowledge workers, the companies have started focusing on developing compensation and career policies for knowledge workers. Since the value addition made by knowledge workers is not conventional, therefore companies have to devise specially tailored compensation packages for knowledge workers. At the moment there are no uniform methods developed for assessing the performance or contribution of knowledge workers, hence most companies devise their own methods of rewarding knowledge workers. For example, in some high technology firms knowledge workers like engineers and scientists are offered a technical career path which runs parallel to the firm's management career path. This option allows the knowledge worker freedom to work on his knowledge domain and at the same time allows him to take on managerial responsibilities. This method of offering parallel career paths to knowledge workers allows the firm to determine his compensation based on managerial grades or scales. In practice the knowledge worker's pay is fixed on the basis of his managerial position but his job profile is more connected to his specialized knowledge domain.

Some hi tech firms follow an entirely different approach for compensating knowledge workers. In these companies, salary adjustments within various classifications for management workers inclusive of knowledge workers are mostly based on maturity curves rather than performance. The logic for using maturity curves rather than performance as criteria for compensation is that the performance of knowledge worker is not only difficult to quantify but also difficult to assess. The difficulty in assessment of performance is mainly because most of the research and development activity undertaken by a knowledge worker has a long gestation period and it does not provide an immediate pay off to the firm. Therefore the prefer rewarding the knowledge worker on the basis of his experience or maturity curves. But this does not mean that firms do not employ performance criteria's for compensating knowledge workers. For instance Lucent Technologies has developed a pay on performance plan for its research and development personnel. This plan emphasizes on profit sharing based on projects and products developed by knowledge workers.

Dual career ladder

Dual career ladders are structures that some scientific, research and technically oriented innovative organizations have developed to compensate and provide knowledge workers with career structure and promotional avenues. Just as in job family structure and in broad band structure 'the value of such configurations is in the intersection of level of responsibility impact, compensation and recognition / status.' Innovative organizations have created dual career structures as a way to acknowledge and reward knowledge workers who contribute to organizational success through their scientific and research work and not by management or executive work. In practice dual career ladder structures rewards knowledge workers without moving them into management roles.

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Following are some of the reasons which make dual career structure attractive to innovative organizations:

- Dual career structure provides scientists, engineers and R & D professionals with sufficient autonomy to pursue their research interests without having to sacrifice reward opportunities or status. In fact dual career structure provides the knowledge worker with avenues to move up in the organizational hierarchy without having to assume management responsibilities.
- Most innovative organizations which have adopted dual career ladder structures believe that this specific structure facilitates recruitment and retention of the best innovative talent available in the market.
- Organisations use dual career ladder structure to display their commitment to research, and engineering excellence. This is kind of commitment is particularly necessary if the innovative organization relies of research and development for its core business's market success.

For dual ladder career structure to be successfully functioning, it is necessary that the career ladder fits perfectly into the culture, values and hierarchy of the innovative organisation which introduces such a structure. Tiles or designations are of particular significance in dual career ladder structure as they serve as indicators of achievement and status across the dual ladder. In other words, it is the designation which acts as indicators of 'comparable statuses' across the ladder. For instance there should an equivalent of vice president representing the management side of the ladder on the other side of the ladder too representing the research and development side of the ladder and that individual could be scientific director etc. In case the dual ladder does not have such personnel representing the R&D side then there would a perception among the executives that it is the management side which is more important and significant than the technical or scientific side of the innovative organisation.

For the successful functioning of the dual career ladder structure, it is essential that 'the actions of the innovative organization are consistent with the intent of the dual ladders.' In other words the organization must ensure that compensation opportunities in terms of base pay, short and long term incentives, benefits etc. should be uniform for employees irrespective of the sides of the ladder which they are in. For instance the employees may be on the opposite sides of ladder but the compensation must be equivalent or uniform to both. This kind of uniformity across the ladder is critical for efficient functioning of the compensation structure, lest it is perceived as unjust or unfair by one section of employees belonging to one pole of the ladder.

Besides dual career ladder, some innovative organisations use other means to motivate and provide recognition to knowledge workers. One such method is by providing 'one time case awards' to innovators or idea generators. For example, International Harvester's share of the combine market jumped from 12 per cent

to 17 per cent due to the introduction of the axial flow combine. The scientist whose six patents contributed to the product development was given $10,000. Similarly IBM uses the 'Chairman's Outstanding Contribution Award.' These awards serve to reward rather than attract and motivate.

Apart from 'one time case awards' some innovative organizations use 'per centage of the take' as means of rewarding and recognizing idea generators. For example international toy and gaming companies often give royalties to inventors of games and toys. These royalties are a fixed per centage of the total net sales of the particular product or game which the inventor helped in developing. Similarly Apple computers claims to give employees royalty for software program they write and which will run on Apple equipment.

Check Your Progress

4. List the two approaches used to determine the base salary of an international employee.
5. Define equalization benefits.
6. Who are termed as knowledge workers?
7. What do you mean by dual career ladder?

13.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The five basic elements of executive compensation package are as follows:
    - Base salary
    - Short-term incentives
    - Long-term incentives
    - Employee benefits
    - Perquisites
2. Perquisite also known as executive benefits, 'perks' are basically to supplement the employee benefit coverage. Executive perquisites can be grouped into three categories, internal, external and personal.
3. Following are the three categories of perks available to an executive:
    (i) Internal perks refers to the 'something extra' that company provides for the executive within its space for instance, a luxury office, private parking, etc.
    (ii) The second category is also company related but is provided when the executive conducts business externally, for instance, club memberships, executive class air travel, etc.

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(iii) The personal categories of perks provided by the company are low cost loans, company- paid family vacations, use of company property etc.

4. The two approaches used to determine the base salary for an international employee are as follows:
   - Following the well-established practices of the parent company
   - Following the practices of the country where the employee is posted or works
5. Equalization benefits are provided to keep the employee in the same financial condition as they were before taking up an international assignment. The objective of equalization benefit is to reduce the negative effects of living in a foreign country.
6. According to Juani Stewart, 'knowledge workers can be defined as employees who apply their valuable knowledge and skills (developed through experience) to complex, novel and abstract problems in environment that provide rich collective knowledge and relational resources.'
7. Dual career ladders are structures that some scientific, research and technically oriented innovative organizations have developed to compensate and provide knowledge workers with career structure and promotional avenues.

13.6 SUMMARY

- Executive compensation package consists of base salary, short-term incentives, long-term incentives, employee benefits and perquisites.
- Short-term incentives are designed to include the downside risk and the upside potential. Since these incentives are tied to performance, the amount of payments received by the executives vary annually.
- Long-term incentives are similar to short-term incentives in most respects, except the duration of performance period which is multi-year. Unlike short-term incentives, these incentives tie payments to achievements of business objectives.
- The growth and spread of communication technology has made national boundaries nothing but mere 'shadow lines' and this blurring of global boundaries has made globalization a reality which most companies of any size has to face. Globalization has not only integrated the markets but also has facilitated increased movement of capital and labour across national boundaries.
- Most organizations which have an international presence employ three kinds of workers, namely, expatriates, local country nationals (LCNs) and third country nationals (TCNs).

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- Indirect monetary compensation refers to the benefits package offered to the employee and this is usually the same as one which is provided by home country.
- Equalization benefits are benefits which are provided to keep the employee in the same financial condition as they were before taking up an international assignment.
- Organizations which depute employees on international assignments are more an often faced with the tricky decision of how to compensate such employees or what should be the approach used for compensating such employees. The company has to grapple with the issue of dealing with two labour markets i.e. the parent country market and host country market.
- The balance sheet method is also known as home country approach because employers offer compensation packages which enables the expatriates to maintain their home living standards while on an international assignment.
- In the host country method, the expatriate is offered the same package as the host country nationals performing the same jobs. This implies that the expatriate makes all the local payments such as social security payments, local taxes etc.
- The objective of the balance sheet method is that 'the expatriate should not suffer a loss as a result of transfer.' This general goal of trying the 'keep the expatriate whole' is the stated objective of compensation packages of companies which operate internationally. In pursuit of this objective most companies design compensation packages which keeps the expatriates' standard of living on par with that of their contemporaries at home.
- According to Reynolds, 'the balance sheet approach to international compensation is a system designed to equalize the purchasing power of employees at comparable position levels living overseas and in the home country and to provide incentives to offset qualitative differences between assignment locations.'
- Balance sheet approach incorporates the four categories of outlays incurred by expatriates such as goods and services, housing, income taxes and reserve.
- Most companies provide hardship incentives to employees who take up assignments in developing countries, locations where the threat of kidnapping or terrorist activity is high, or to remote locations (such as rain forests of Brazil or on an ocean oil drilling platform) or locations with primitive living conditions.
- Among all the equalization adjustments the most common is the cost of living adjustments (COLA) and this is offered by almost all companies to expatriates. The main objective behind COLA is to provide the expatriate with the same standard of living in the foreign assignment that he would have had at home.

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- Knowledge workers as defined by Drucker 'are individuals who have high levels of education and special skills combined with the ability to apply these skills to identify and solve problems.'
- Knowledge workers include computer professionals, scientists, engineers, research personnel and they tend to work in high technology firms and are usually experts in some abstract knowledge base.
- Innovative organizations design compensation or pay systems to encourage 'internal motivation' by giving opportunities to the knowledge worker to pursue his ideas, by providing promotional avenues and by acknowledging employees' contribution by giving him/her incentives or special compensation.
- Dual career ladders are structures that some scientific, research and technically oriented innovative organizations have developed to compensate and provide knowledge workers with career structure and promotional avenues.
- Dual career structure provides scientists, engineers and R & D professionals with sufficient autonomy to pursue their research interests without having to sacrifice reward opportunities or status.
- For dual ladder career structure to be successfully functioning, it is necessary that the career ladder fits perfectly into the culture, values and hierarchy of the innovative organisation which introduces such a structure.

13.7 KEY WORDS

- **Executive compensation:** It is also termed as executive pay and is composed of the financial compensation and other non-financial awards received by an executive from their firm for their service to the organization.
- **Indirect compensation:** It is a non-monetary benefit provided to employees in addition to their salary. These benefits are important because they can help companies in attracting and retaining talent.
- **Expatriates:** It refers to the employees assigned to work in another country

13.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. Briefly mention some complexities involved in international compensation.
2. What are the three categories of international employees?

3. Give some examples of equalization benefits provided by the companies.
4. What is balance sheet approach of expatriate compensation?

Long Answer Questions

1. What are the components of executive compensation? Discuss.
2. Describe the objectives of international compensation programme.
3. Discuss the basic approaches for designing expatriate compensation.
4. What are the advantages and disadvantages of balance sheet approach?

13.9 FURTHER READINGS

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UNIT 14 WAGE INCENTIVE SCENARIO IN INDIA

Structure

14.0 INTRODUCTION

An employee compensation does not only cover the base salary but the entire compensation package inclusive of the base salary. In addition to the base pay, a compensation package also consists of a number of other components such as benefits, allowances, incentive schemes etc. In this unit, we are going to study about wage incentive trends in India. In order to attract and retain talented employees within the organization, every organization attempts to make its compensation package attractive. Wage incentive plans are aimed to improve the profit of the company through a reduction in the unit costs of labour and materials or both. These are basically performance-linked compensation paid to improve motivation and productivity. Besides focusing on the types of wage incentive plans, the unit will also discuss compensation and satisfaction, compensation and motivation, and compensation for knowledge personnel.

14.1 OBJECTIVES

After going through this unit, you will be able to:

- Summarize the current wage incentive scenario in India
- Discuss the several features of incentive schemes in India

- Explain the different types of wage incentive plans
- Discuss how compensation is related to satisfaction and motivation
- Analyse the compensation for knowledge personnel

14.2 INTRODUCTION TO WAGE INCENTIVES IN INDIA

The schemes of incentive payment were introduced first in India in the year 1946. These days, incentives are very much popular in our country. There are also differences in from one industry to another industry. There is no single scheme that followed throughout the country. The schemes are partially followed and introduced by International Labour Association (ILO).

The incentive plans is too difficult to follow as prescribed by ILO because measurement of performance is tremendously difficult. There are few companies awarding such incentives on the basis of work performance to group as well as not individuals. Similarly, production bonus is also popular in our country. The norms for payment term are also fixed on job analysis and motion studies.

Wage incentives involve to performance based compensation that are paid to improve employees' motivation and work productivity. It is the monetary attraction that offered to the employees to make them perfectionist of their standards and services. According to the National Commission of Labour "wage incentives are extra monetary motivation".

Features of Incentive Schemes

There are several features of incentive schemes in India as follows:

1. The incentive scheme is introduced in India in the year 1946 while the scheme is also still in undeveloped stage.
2. There is no constancy of incentive schemes. Every company and establishments have adopted various schemes that for better analysis or convenient. Motion and time studies, job analysis or consultation with unions are not linked on under these schemes.
3. They do not follow any guidelines while adopting incentive schemes.
4. Payment of incentives are failed to motivate employee for better performance because the present of grandiosity despoil the joy of getting additional payment. Incentives are therefore need to be endorsed.
5. Every aspect of incentives is also not negative in our country. However, there are many establishments and undertakings objective that increased productivity are attained.

6. In some cases where group incentive schemes are in a trends, a system fails to operate effectively because of no direct link between efforts and earnings.

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Non – Monetary Incentives

Monetary incentive serves the purpose of the employees mind as motivator while several non-monetary factors are also available to capture the attention of the employees' mind and keep them enthusiastic in their performance. The creation of these rewards depends upon executive's inventiveness and skill to assess recompense.

Some of the non-monetary incentives those motivate employees are as follows:

(1) An employee having strong need for affiliation may accept job assignment that they feels attractive, enthusiastic and satisfying.

(2) There are some factors that are considered as a status symbol for motivating the person, like sophisticated furniture's, wall paintings, personal assistant, respectable job title, visiting cards, name plate etc.

(3) There are some passionate person for power can respond to accepting administrative responsibility and produce positive results.

(4) Commanding an employee's work in front of their colleagues and group may also motivate them for better work performance. These gestures also motivate others.

(5) If employees have any past experience in recognized organisation by inviting him to participate in some complex assignment, then he feels delighted and gives his hundred percent potential.

(6) The employee can be given more responsibility in recognition of seniority basis.

(7) Award are given to the employee for best safety performer can also motivate the employee towards excellency.

14.3 INTRODUCTION TO TYPES OF WAGE INCENTIVE PLANS

A system of wage payment that would maintain both quality and quantity is called incentive wage plan, and it is naturally a judicious combination of both basic systems of wage payments, i.e., time and piece wages. Under the incentive plans of wage payment, both time wage and piece wage systems are blended together in such a manner that the workers are induced to increase their productivity.

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Essentials of a perfect Wage Incentive Plan:

1. Measurement of the amount of work done.
2. Establishment of standard output on the basis of which the incentive has to be worked out.
3. Setting up a suitable rate of incentive.

Types of incentive plans: The following are some important plans of incentive wage payment:

1. **Halsey plan:** It is a plan originated by F.A. Halsey to encourage efficiency among workers as well as to guarantee them wages according to time basis. The standard time required for a job is determined beforehand on the basis of time and motion studies. Workers who perform the job in less than the standard time and thus save time are rewarded with a bonus but the worker who takes longer than the standard time is not punished and is paid wages according to time wage system. The total earnings of a worker under this plan consist of wages for the actual time plus a bonus which is equal to the money value of 33 per cent of the time saved in case of standard time set on previous experience, and 50 per cent of the time saved when the standards are scientifically set.
2. **Rowan plan:** Wages, according to time basis, are guaranteed and the slow worker is not made to suffer. A standard time is determined before and a bonus is paid according to time saved. The only difference between Halsey Plan and Rowan Plan relates to the calculation of bonus. Under this plan bonus is based on that proportion of the time saved which the time taken bears to the standard time.
3. **Taylor's differential piece wage plan:** Under this plan, there is no guarantee of wages. The standard of output is fixed per hour or per day and two piece wage rates are laid. Those exceeding the standard or even just attaining it, are entitled to the higher rate and those, whose output is less than the standard output are paid at a lower rate. For example, the standard may be fixed at 40 units per day and the piece rates may be 30 paisa and 25 paisa per unit. If a worker produces 40 units he should get wages at the rate of 30 paisa, i.e., ₹ 12. If he produces only 39 units he would be paid at the rate of 25 paisa per unit so his wages will be ₹ 9.75.
4. **The Emerson efficiency system:** In this system, the worker is allowed a certain time within which he is required to complete his job. If he completes the job within the required time, he is paid bonus. If he takes longer than the required time, he receives a lower bonus. Under this system, the daily wage is guaranteed.

5. **The Gantt system:** This system is similar to the Emerson efficiency system. The worker receives the bonus only if he attains the required standard of efficiency. No bonus is paid to a worker where his efficiency is less than 100%. The foreman is also given a bonus if the worker under his care attains the required standard of efficiency.
6. **Bedeaux point premium plan:** The chief novelty of this plan is that the value of time saved is divided between workers and foreman, 3/4 to workers and 1/4 to foreman. This is done on the basis that a worker cannot show good results if his foreman does not fully cooperate with him. Therefore, the foreman is also entitled to an incentive.

Variable Compensation Individual and Group

Incentive compensation, also called 'payment by result', is essentially a managerial device for increasing workers' productivity. Further, it is a method of sharing gains in productivity with workers by rewarding them financially for their increased rate of output. The payment by results scheme is directly related to an employee's productivity. There are many variations of incentive wage system. The simplest method is that of paying a workman by the number of units of a product he produces. The objective of an incentive wage system is relating wages to output, thereby stimulating greater output at lower costs. Incentive system also helps in narrowing the gap between management and workers and bringing them closer together with a commonality of goals and targets. Many authors have defined the term wage incentives.

In the words of Hummel and Nickerson, wage incentives 'refers to all the plans that provide extra pay for extra performance in addition to regular wages for a job.'

According to Scott, Wage incentives 'is any formal and announced program under which the income of an individual, a small group, a plant work force or all the employees of a firm are partially or wholly related to some measure of productivity output.'

Broad Categories of Wage Incentive Schemes

A wide variety of incentive wage plans has been devised by industries under which the workers earnings are related directly to some measurement of work done either by himself or by his group. There are three broad categories of incentive schemes as classified by Dunn and Rachel. They are:

1. Simple incentive plan
2. Sharing incentive wage plan
3. Group incentive plan

1. **Simple incentive plan:** The simplest of all wage incentives may be described as the straight piece-rate system. The piece-work method is perhaps one of the oldest and simplest of the incentive plans. The basis of computation is the rate per piece multiplied by the number of pieces produced. For example, if the piece-rate is ₹ 2 for each unit of output, then a worker who produces 10 units in a given time, say 8 hours, will be paid ₹ 20. Another worker whose production is 12 units in the given time (i.e., 8 hours) will receive ₹ 24, and so on.

   This method of payment is suitable if the process of production is standardized and large quantities are produced by repetitive work. The system is not suitable where workers by working rapidly to earn more wages are likely to lower the quality of the goods they produce.

2. **Sharing incentive wage plan:** There are a large number of plans in this category. These plans are the modifications of the Taylor's differential piece rate incentive plan. Under this plan, the workers exceeding the standard are entitled to the higher rate and those, whose output is less than the standard output, are paid at a lower rate. Taylor's philosophy was to attain a high level of output. Therefore, there was a differential piece rate, low rates for output below the standard and high rate for output above the standard.

3. **Group incentive plan:** Individual incentive scheme is not suited to cases where several workers are required to perform jointly a single operation. In such cases, a team approach is called for, with all the members of that team doing their share to achieve and maintain the output. The advantage of group incentive plans is that they encourage team spirit and a sense of mutual cooperation among workers. Under the group incentive plan, each member of the group is determined first of all by measuring the amount of the production which passes inspection as it leaves the group. The total earnings for the group are then determined and if all the members are of equal skill, these earnings are usually divided among them equally. There are three broad categories of incentive schemes

   (i) Simple Incentive Plan

   (ii) Sharing Incentive Wage Plan

   (iii) Group Incentive Plan.

Check Your Progress

1. When was the scheme of incentive payment introduced in India?
2. What do you mean by wage incentives and what does it involve?
3. What are the essentials of a perfect wage incentive plan?

14.4 COMPENSATION WITH RESPECT TO SATISFACTION, MOTIVATION AND KNOWLEDGE PERSONNEL

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Let us now study the concept of compensation in relation to satisfaction, motivation and knowledge personnel.

14.4.1 Compensation and Satisfaction

Human resources are the pivot part of the organisational effectiveness and the greatest asset of the organisation. The retentiveness of skilful and well equipped workforce in an organisation is germane for the growth of the organisation and overall performance of the employee. The employees' are surely contribute their efficiency effort to the organisation for achieving its competitive environment against their competitors. Compensation, work environment and other factors influences the employee's mind satisfaction. Career development opportunities, flexible work schedules and attractive surroundings can improve the job satisfaction of the employees in a cost effective manner. This typically results in improved morale, reduced absenteeism, fewer conflicts on the job and increased productivity. Increased only compensation does not always lead to increased job satisfaction among their employees. However, sometimes a small increase can also have a negative effect for the organisation.

Optimism

Both compensation and job satisfaction have created impact of the employee morale. The supervisor's leadership style, employee's skill level and the decision-making authority are also affect an employee's attitude and personality toward his job services. For example, when people work for a despotic leader who makes all the decisions without consulting his staff, if the compensation is high, job satisfaction and morale disposed to be low. When people does not feel permitted to contribute to the inclusive planning, organization and direction of the company, they does not committed to the long-term success of the business or the organisation.

Habitual absence from work

High levels of compensation may not be compensate for the impost to the employee, when the workplace represents high levels of stress, unsafe conditions or uncertainty, it affects the employee's personal life. Maintaining a well balancing proportionate between work perfection and home ensures that employees can come to work thoroughly and manage their job tasks with minimal distractions. Worker absenteeism can create costs of the economy very less every year in lost productivity.

Efficiency

When employee's job satisfaction decreases then productivity also suffers. By improving their performance they are providing interesting work and empowering

employees to take charge of their own tasks. However, providing such individual rewards can also erode teamwork, creativity and innovation, by avoiding such incentives for team awards. Incentive schemes positively impact job satisfaction and productivity, while monitoring the programs to ensure that there are no unanticipated ill effects.

14.4.2 Compensation and Motivation

There are million question faced by most managers today that 'How can I motivate, engage and retain employees?' With heavy competition for top talent heating up, figuring out a way to keep the best people motivated and productive at work, one of the top priorities for employers that is rapidly increasing. Many employers believe that a supremacy level of compensation package holds the key to employee engagement, successful effort and motivation.

According to research, compensation packages have a supremacy of impact on an employees' level of engagement. High compensation provides a pleasure and joyful mind of satisfaction to the employees from their job and incentivised them to perform better services, especially when compensation is directly based upon job performance. On the contrary, research has also shown that low compensation obstructs employee's motivation, work ability and performance. Overall, compensation positively affects employees in one or more of the following ways:

- Job satisfaction
- Retention
- Potentially recruitment
- Work productivity

Compensation is important in engaging employees, while it will not achieve its maximum potentiality when placed in an emptiness. Companies or any organisation need a good plan and execution strategy to truly allow compensation to achieve its goal and also create maximum potential.

An effective compensation package emanates from good compensation planning. Compensation planning is done on basically spreadsheets which is far from the most effective way. Managers should consider the integrating compensation management software into their Human Resource department. Such software will allow managers to:

- To simplify the complexity of the calculations
- By eliminating the need for the spreadsheets
- To create better visibility and compliance
- Offer better decision support
- By reducing costly errors related with the spreadsheets

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By creating such plan, effective compensation management software helps to exchange their ideas of the plan to the employees so that they understand the details of the package.

It is to common knowledge that employers use various compensation strategies or plan to motivate their employees towards their goals. Most of the individuals are provided with their base pay to engage with the company and ensure their continuation performance. In many cases, base salary will only encourage incentives to an employee to work at the high level that required for them to keep their perfect job performance. If employers want staff members to perform at a superior level, they have to gives opportunity to the employees to earn incentives or additional payment benefits.

Incentive plans are one way to motivate employees to gives more effort, while they are usually not very versatile. Most incentive plans involve performance based monetary or payment based on performance arrangement wherein employees are rewarded for the achievement of specific objectives. These types of compensation strategies are tend to be of medium range duration and involves the performance criteria that gets broad operational or financial metrics.

14.4.3 Compensation for Knowledge Personnel

A system of payment where employees are compensated based on their individual skill level, educational qualification and experiences. Under this system, employees are rewarded for reaching certain goals in education, training, experiences and skill development. Knowledge-based payment systems provide incentive for employees to improve their skill development and educational qualification. The concept of knowledge based payment system focuses on an individual employee's ability to improve their education so as to increase salary or other compensation benefits. As the employee enhances their scope of knowledge, then the employee can generally takes on more complicated and lucrative projects on behalf of the company or the organisation.

In some businesses, the organisational structure encourages the employees' educational development and efficiency status. Employees are also rewarded upon obtaining certain high level educational goals. This may or may not be formal accredited education, whereas it may include homestead education or training and skill development from third parties.

Generally, the parties agree on this type of pay structure at the time of hiring, notwithstanding companies can also incorporate this type of system at any time, upon their agreement of any union or contracts.

A knowledge based payment system can empower individuals to improve their work abilities on the job. Often an individual can receive a specific amount of pay increase when they achieve the next level of education. The system may be gradation or involve various steps that must be achieved by the employees.

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Knowledge-linked payment systems can encourage employees to become lifelong learners, which can help a company to maintain their reputation in the industry. This system can also leads to create greater innovation, longer retention of skilled or experiences employees and higher revenues or monetary benefits as a result of high-quality workmanship.

Check Your Progress

4. How can the job satisfaction of the employees be improved?
5. Why is employee compensation important?
6. What are the key focus areas of knowledge based payment system?

14.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The schemes of incentive payment were introduced first in India in the year 1946.
2. Wage incentives involve to performance based compensation that are paid to improve employees' motivation and work productivity. It is the monetary attraction that offered to the employees to make them perfectionist of their standards and services. According to the National Commission of Labour "wage incentives are extra monetary motivation".
3. The essentials of a perfect wage incentive plan are as follows:
   (i) Measurement of the amount of work done.
   (ii) Establishment of standard output on the basis of which the incentive has to be worked out.
   (iii) Setting up a suitable rate of incentive.
4. The job satisfaction of the employees can be improved in a cost effective manner with the implementation of career development opportunities, flexible work schedules and attractive surroundings. This typically results in improved morale, reduced absenteeism, fewer conflicts on the job and increased productivity.
5. Employee compensation is very important as it positively affects employees in one or more of the following ways:
   - Job Satisfaction
   - Retention
   - Potentially recruitment
   - Work productivity

6. The concept of knowledge based payment system focuses on an individual employee's ability to improve their education so as to increase salary or other compensation benefits. As the employee enhances their scope of knowledge, then the employee can generally takes on more complicated and lucrative projects on behalf of the company or the organisation.

14.6 SUMMARY

- The schemes of incentive payment were introduced first in India in the year 1946. These days, incentives are very much popular in our country. There are also differences in from one industry to another industry. There is no single scheme that followed throughout the country. The schemes are partially followed and introduced by International Labour Association (ILO).
- Wage incentives involve to performance based compensation that paid to improve employees' motivation and work productivity. It is the monetary attraction that offered to the employees to make them perfectionist of their standards and services.
- Monetary incentive serves the purpose of the employees mind as motivator while several non-monetary factors are also available to capture the attention of the employees' mind and keep them enthusiastic in their performance.
- A system of wage payment that would maintain both quality and quantity is called incentive wage plan, and it is naturally a judicious combination of both basic systems of wage payments, i.e., time and piece wages.
- Under the incentive plans of wage payment, both time wage and piece wage systems are blended together in such a manner that the workers are induced to increase their productivity.
- Various types of incentive plans are Halsey plan, Rowan plan, Taylor's differential piece wage plan, the Emerson efficiency system, the Gantt system, and Bedeaux point premium plan.
- Incentive compensation, also called 'payment by result', is essentially a managerial device for increasing workers' productivity. Further, it is a method of sharing gains in productivity with workers by rewarding them financially for their increased rate of output.
- A wide variety of incentive wage plans has been devised by industries under which the workers earnings are related directly to some measurement of work done either by himself or by his group. There are three broad categories of incentive schemes as classified by Dunn and Rachel. They are: simple incentive plan, sharing incentive wage plan, group incentive plan.
- Both compensation and job satisfaction have created impact of the employee morale. The supervisor's leadership style, employee's skill level and the

decision-making authority are also affect an employee's attitude and personality toward his job services.

- High levels of compensation may not be compensate for the impost to the employee, when the workplace represents high levels of stress, unsafe conditions or uncertainty, it affects the employee's personal life.
- In many cases, base salary will only encourage incentives to an employee to work at the high level that required for them to keep their perfect job performance.
- Compensation for knowledge personnel is a system of payment where employees are compensated based on their individual skill level, educational qualification and experiences. Under this system, employees are rewarded for reaching certain goals in education, training, experiences and skill development.
- Knowledge-based payment systems provide incentive for employees to improve their skill development and educational qualification. The system can empower individuals to improve their work abilities on the job.

14.7 KEY WORDS

- **Wage incentives:** It refers to performance linked compensation paid to improve motivation and productivity.
- **Incentive compensation:** It refers to the portion of an employee's salary that is related to performance and not a guaranteed payment.
- **Halsey Plan:** Under Halsey Plan, the standard time for the completion of a job is fixed and the rate per hour is then determined.

14.8 SELF ASSESSMENT QUESTIONS AND EXERCISES

Short Answer Questions

1. What is the purpose of wage incentive plans?
2. What are the features of incentive schemes in India?
3. Briefly mention about the non-monetary incentives that motivate employees.
4. How does motivation relate to compensation?

Long Answer Questions

1. Discuss the various types of wage incentive plans.
2. Describe the three incentive schemes as classified by Dunn and Rachel.
3. What is the relationship between job satisfaction and compensation? Discuss.

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14.9 FURTHER READINGS

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